FEDERAL REGISTER

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Rules, Regulations, Orders

TITLE 7—AGRICULTURE

CHAPTER IX—DIVISION OF MARKETING AND MARKETING AGREEMENTS

[Order No. 4, as amended.]

PART 904—ORDER MAKING EFFECTIVE ORDER NO. 4, AS AMENDED, REGULATING THE HANDLING OF MILK IN THE GREATER BOSTON, MASSACHUSETTS, MARKETING AREA*

Whereas, H. A. Wallace, Secretary of Agriculture of the United States of America, pursuant to the powers conferred upon the Secretary by Public Act No. 10, 73d Congress, as amended and as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, issued on January 19, 1940, Order No. 4, as amended,[1] regulating the handling of milk in the Greater Boston, Massachusetts, marketing area, said order, as amended, to become effective at such time as the Secretary might subsequently declare; and

Whereas, the requirements of section 8c (9) of the act have been complied with:

Now, therefore, H. A. Wallace, Secretary of Agriculture of the United States, pursuant to the powers conferred upon the Secretary by Public Act No. 10, 73d Congress, as amended and as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, hereby declares that said Order No. 4, as amended, regulating the handling of milk in the Greater Boston, Massachusetts, marketing area shall be effective on and after 12:01 a. m., e. s. t., February 4, 1940, and hereby orders that from said date such handling of milk produced for sale in the Greater Boston, Massachusetts, marketing area as is in the current of interstate commerce or as directly burdens, obstructs, or affects interstate commerce, shall, from such effective date, be in conformity to and in compliance with the terms and conditions of Order No. 4, as amended.

I hereby determine that an emergency exists which requires a shorter period of notice than that specified in Article III, Section 300, of the General Regulations, Series A, No. 1, as amended, of the Agricultural Adjustment Administration, United States Department of Agriculture, and that the filing of this order with the Division of the Federal Register on or before February 3, 1940, will constitute, under the circumstances, reasonable notice.

In witness whereof, H. A. Wallace, Secretary of Agriculture of the United States, has executed this order in duplicate and has hereunto set his hand and caused the official seal of the Department of Agriculture to be affixed hereto in the city of Washington, District of Columbia, this 1st day of February 1940.

[SEAL] H. A. WALLACE,
Secretary of Agriculture.

[F. R. Doc. 40-496; Filed, February 1, 1940; 2:07 p. m.]

*This order issued under authority contained in 48 Stat. 31 (1933), 7 U.S.C. § 601 et seq. (1934); 49 Stat. 750 (1935); 50 Stat. 246 (1937), 7 U.S.C. § 601 et seq. (Supp. IV, 1938).

[1] 5 F.R. 248 DI.

[Order No. 34—Amendment No. 1]

PART 934—ORDER MAKING EFFECTIVE AMENDMENT NO. 1 TO ORDER NO. 34 REGULATING THE HANDLING OF MILK IN THE LOWELL-LAWRENCE, MASSACHUSETTS, MARKETING AREA*

Whereas, H. A. Wallace, Secretary of Agriculture of the United States of America, pursuant to the powers conferred upon the Secretary by Public Act No. 10, 73d Congress, as amended and as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, issued, on January 19, 1940, Amendment No. 1,

*This order issued pursuant to the authority contained in 48 Stat. 31 (1933), 7 U.S.C. § 601 et seq. (1934); 49 Stat. 750 (1935); 50 Stat. 246 (1937), 7 U.S.C. § 601 et seq. (Supp. IV 1938).

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FEDERAL REGISTER

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to Order No. 34,[1] regulating the handling of milk in the Lowell-Lawrence, Massachusetts, marketing area, said amendment to become effective at such time as the Secretary might subsequently declare; and

Whereas, the requirements of section 8c (9) of the Act have been complied with:

Now, therefore, H. A. Wallace, Secretary of Agriculture of the United States, pursuant to the powers conferred upon the Secretary by Public Act No. 10, 73d Congress, as amended and as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, hereby declares that said Amendment No. 1 to Order No. 34 regulating the handling of milk in the Lowell-Lawrence, Massachusetts, marketing area shall be effective on and after 12:01 a. m., e. s. t., February 4, 1940, and hereby orders that such handling of milk produced for sale in the Lowell-Lawrence, Massachusetts, marketing area as is in the current of interstate commerce or as directly burdens, obstructs, or affects interstate commerce, shall, from such effective date, be in conformity to and in compliance with the terms and conditions of Order No. 34 as amended by said Amendment No. 1.

I hereby determine that an emergency exists which requires a shorter period of notice than that specified in Article III, Section 300, of the General Regulations, Series A, No. 1, as amended, of the Agricultural Adjustment Administration, United States Department of Agriculture, and that the filing of this order with the Division of the Federal Register on or before February 3, 1940, will constitute, under the circumstances, reasonable notice.

In witness whereof, H. A. Wallace, Secretary of Agriculture of the United States, has executed this order in duplicate and has hereunto set his hand and caused the official seal of the Department of Agriculture to be affixed hereto in the city of Washington, District of Columbia, this 1st day of February 1940.

[SEAL] H. A. WALLACE,
Secretary of Agriculture.

[F. R. Doc. 40-494; Filed, February 1, 1940; 2:06 p. m.]

TITLE 12—BANKS AND BANKING

CHAPTER II—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

INTERLOCKING BANK DIRECTORATES UNDER THE CLAYTON ACT

REGULATION L AMENDED

On February 1, 1940, the Board of Governors of the Federal Reserve System adopted the following resolution:

Resolved, That Regulation L [12 CFR. 212], Interlocking Bank Directorates Under the Clayton Act, be amended, effective immediately, as follows:

1. By changing the date "February 1, 1940" in section 3 (a) [12 CFR.212.3 (a)] to the date "June 1, 1940"; and

2. By changing the date "February 1, 1940" in section 3 (e) [12 CFR.212 3 (e)] to the date "June 1, 1940." [Sec. 8, 38 Stat. 732; Sec. 329, 49 Stat. 717; Sec. 11, 38 Stat. 734; Sec. 602 (d), 48 Stat. 1102; 15 U.S.C. 19 and Sup. III; 15 U.S.C. 21]

[SEAL] S. R. CARPENTER,
Assistant Secretary.

[F. R. Doc. 40-497; Filed, February 1, 1940; 3:29 p. m.]

TITLE 17—COMMODITY AND SECURITIES EXCHANGES

CHAPTER I—SECURITIES AND EXCHANGE COMMISSION

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

AMENDMENT OF RULE U-5B-1, ADOPTION OF AMENDED FORM U5B, AND ADOPTION OF FORM U5B—SPECIAL SUPPLEMENT

Acting pursuant to the authority conferred upon it by the Public Utility Holding Company Act of 1935, particularly Sections 5 (b), 14 and 20 (a) thereof [C. 687, sec. 5, 49 Stat. 812; 15 U.S.C., Sup. III, 79e: C. 687, sec. 14, 49 Stat. 827; 15 U.S.C., Sup. III, 79n: C. 687, sec. 20, 49 Stat. 833; 15 U.S.C., Sup. III, 79t], and finding such action necessary and appropriate in the public interest and for the protection of investors and consumers, and to carry out the provisions of said Act, the Securities and Exchange Commission hereby amends Rule U-5B-1 [Sec. 250.U-5B-1] to read as follows:

§ 250.U-5B-1 (*Rule U-5B-1*) *Registration statements—Form and time of filing.*

(a) Form U5B [Sec. 259.U5B] marked "Adopted May 17, 1938 and amended February 1, 1940",[1] is prescribed as the form for registration statements required to be filed with the Commission, pursuant to Section 5 [C. 687, sec. 5, 49 Stat. 812; 15 U.S.C., Sup. III, 79e] of the Act, by any registered holding company which may be required to file such a registration statement on or after May 1, 1940. Any registered holding company filing a registration statement prior to May 1, 1940 may at its election file on Form U5B [Sec. 259.U5B] marked "Adopted May 17, 1938", or on said form as so amended. Every registered holding company which has not filed its registration statement on Form U5B [Sec. 259.U5B] marked "Adopted May 17, 1938 and amended February 1, 1940" shall file, on or before July 1, 1940, a special report revising Exhibits D and E of the registration statement of such company. Form U5B [Sec. 259.U5B]—Special Supplement marked "Adopted February 1, 1940",[1] is prescribed as the form for such special report.

(b) Any holding company filing a notification of registration pursuant to the provisions of Section 5 (a) [C. 687, sec. 5, 49 Stat. 812; 15 U.S.C., Sup. III, 79e], shall file with the Commission a registration statement on Form U5B [Sec. 259.U5B] within 90 days after the filing of such notification of registration, and any company filing such a notification prior to becoming a holding company shall file such statement on Form U5B [Sec. 259.U5B] within 90 days after the date of becoming a holding company.

(c) The Commission, upon a showing of reasonable cause therefor, may ex-

[1] 5 F.R. 254 DI.

[1] Not filed as part of the original document.

tend the time for any filing required by this rule. The information contained in registration statements filed pursuant to this rule shall be kept current in the manner prescribed by Rule U–14–2 [Sec. 250.U–14–2].

Effective February 3, 1940.

By the Commission.

[SEAL] FRANCIS P. BRASSOR, *Secretary.*

[F. R. Doc. 40–507; Filed, February 2, 1940; 12:26 p. m.]

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

AMENDMENT OF RULE U–14–2 AND ADOPTION OF AMENDED FORM U5S

Acting pursuant to the authority conferred upon it by the Public Utility Holding Company Act of 1935, particularly Sections 14 and 20 (a) thereof [C. 687, sec. 14, 49 Stat. 827; 15 U.S.C., Sup. III, 79n: C. 687, sec. 20, 49 Stat. 833; 15 U.S.C., Sup. III, 79t], and finding such action necessary and appropriate in the public interest and for the protection of investors and consumers, and to carry out the provisions of said Act, the Securities and Exchange Commission hereby amends Rule U–14–2 [Sec. 250. U–14–2] to read as follows:

§ 250.U–14–2 *(Rule U–14–2) Annual supplements to registration statements—Form and time of filing.* Form U5S [Sec. 259.U5S], marked "Adopted February 1, 1940," is prescribed as the form for annual supplements to registration statements to be filed by registered holding companies pursuant to Section 14 [C. 687, sec. 14, 49 Stat. 827; 15 U.S.C., Sup. III, 79n] of the Act and for the purpose of keeping current the information contained in the registration statements of such companies. Such annual supplement shall be filed on or before the first day of May in each year and shall be filed by every company which has filed with the Commission before December 31 of the preceding year a registration statement on Form U5B [Sec. 259.U5B]. The first annual supplement shall cover the period since the date of the information filed pursuant to the U5B statement up to the close of the last calendar year.

The Commission, upon a showing of reasonable cause therefor, may permit the filing of a supplement on other than a calendar year basis or extend the time within which any such supplement is to be filed.

Effective February 3, 1940.

By the Commission.

[SEAL] FRANCIS P. BRASSOR, *Secretary.*

[F. R. Doc. 40–505; Filed, February 2, 1940; 12:26 p. m.]

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

AMENDMENT OF RULE U–12E–2

The Amendment of Rule U–12E–2 promulgated by the Commission, to be effective on January 26, 1940, and published on page 316 of the FEDERAL REGISTER for Saturday, January 27, 1940, is corrected insofar as the caption of that document is concerned. This caption should read "Amendment of Rule U–12E–2" instead of "Amendment of Rule U–12F–2".

By the Commission.

[SEAL] FRANCIS P. BRASSOR, *Secretary.*

[F. R. Doc. 40–506; Filed, February 2, 1940; 12:26 p. m.]

TITLE 26—INTERNAL REVENUE

CHAPTER I—BUREAU OF INTERNAL REVENUE

[Regulations 103]

INCOME TAX UNDER THE INTERNAL REVENUE CODE*

[The table of contents, Subpart A (Introductory Provisions) and Subpart B (General Provisions) appeared in the issue for Thursday, February 1, 1940. Subpart C (Supplemental Provisions) appeared in the issue for Friday, February 2, 1940.]

SUBPART D—PERSONAL HOLDING COMPANIES

SEC. 500. SURTAX ON PERSONAL HOLDING COMPANIES.

There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1938, upon the undistributed subchapter A net income of every personal holding company (in addition to the taxes imposed by chapter 1) a surtax equal to the sum of the following:

(1) 65 per centum of the amount thereof not in excess of $2,000; plus

(2) 75 per centum of the amount thereof in excess of $2,000.

§ 19.500–1 *Surtax on personal holding companies.* Section 500 imposes for each taxable year beginning after December 31, 1938 (in addition to the taxes imposed by chapter 1), a graduated income tax or surtax upon corporations classified as personal holding companies and, under the circumstances specified in section 501 (c), upon an affiliated group of railroad corporations. Corporations so classified are exempt from the surtax on corporations improperly accumulating surplus imposed by section 102, but are not exempt from the other taxes imposed by chapter 1. Unlike the surtax imposed by section 102, the surtax imposed by section 500 applies to all personal holding companies defined as such in section 501 and section 19.501–1, regardless of whether or not they were formed or availed of to accumulate earnings or profits for the purpose of avoiding surtax upon shareholders. The surtax imposed by section 500 is 65 percent of the amount of the undistributed subchapter A net income not in excess of $2,000, and 75 percent of the amount of the undistributed subchapter A net income in excess of $2,000.

A foreign corporation, whether resident or nonresident, which is classified as a personal holding company under section 501 (not including a foreign personal holding company as defined in section 331) is subject to the tax imposed by section 500 with respect to its income from sources within the United States even though such income is not fixed or determinable annual or periodical income specified in section 231 (a). (See section 119.) The term "personal holding company," as used in subchapter A of chapter 2, does not include a foreign corporation if (1) its gross income from sources within the United States for the period specified in section 119 (a) (2) (B) is less than 50 percent of its total gross income from all sources and (2) all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through other foreign corporations.*

SEC. 501. DEFINITION OF PERSONAL HOLDING COMPANY.

(a) *General rule.* For the purposes of this subchapter and chapter 1, the term "personal holding company" means any corporation if—

(1) *Gross income requirement.* At least 80 per centum of its gross income for the taxable year is personal holding company income as defined in section 502; but if the corporation is a personal holding company with respect to any taxable year beginning after December 31, 1936, then, for each subsequent taxable year, the minimum percentage shall be 70 per centum in lieu of 80 per centum, until a taxable year during the whole of the last half of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 70 per centum of the gross income is personal holding company income; and

(2) *Stock ownership requirement.* At any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals.

(b) *Exceptions.* The term "personal holding company" does not include a corporation exempt from taxation under section 101, a bank as defined in section 104, a life insurance company, a surety company, or a foreign personal holding company as defined in section 331, or a licensed personal finance company, under State supervision, at least 80 per centum of the gross income of which is lawful interest received from individuals each of whose indebtedness to such company did not at any time during the taxable year exceed $300 in principal amount, if such interest is not payable in advance or compounded and is computed only on unpaid balances.

(c) *Corporations making consolidated returns.* If the common parent corporation of

*Sections 19.1–19.3801 (e)–1 issued under the authority contained in sections 62 and 3791 of the Internal Revenue Code (53 Stat. 32, 467). In such sections the numbers to the right of the decimal point are keyed to numbers of sections 1 to 373, inclusive, 500 to 511, inclusive, 3797, and 3801 of the Internal Revenue Code (53 Stat., Part 1).

an affiliated group of corporations making a consolidated return under the provisions of section 141 satisfies the stock ownership requirement provided in section 501 (a) (2), and the income of such affiliated group, determined as provided in section 141, satisfies the gross income requirement provided in section 501 (a) (1), such affiliated group shall be subject to the surtax imposed by this subchapter.

§ 19.501–1 *Definition of personal holding company.* A personal holding company is any corporation (other than a corporation specified in section 501 (b)) which for the taxable year meets (a) the gross income requirement specified in section 19.501–2, and (b) the stock ownership requirement specified in section 19.501–3. Both requirements must be satisfied and both must be met with respect to each taxable year.*

§ 19.501–2 *Gross income requirement.* To meet the gross income requirement, it is necessary that either of the following percentages of gross income of the corporation for the taxable year be personal holding company income as defined in section 502:

(a) 80 percent or more; or

(b) 70 percent or more if the corporation has been classified as a personal holding company for any taxable year beginning after December 31, 1936, unless—

(1) a taxable year has intervened since the last taxable year for which it was so classified, during no part of the last half of which the stock ownership requirement specified in section 501 (a) (2) exists; or

(2) three consecutive years have intervened since the last taxable year for which it was so classified, during each of which its personal holding company income was less than 70 percent of its gross income.

In determining whether the personal holding company income is equal to the required percentage of the total gross income, the determination must not be made upon the basis of gross receipts, since gross income is not synonymous with gross receipts. For a further discussion of what constitutes "gross income," see section 22 (a) and sections 19.22 (a)–1 to 19.22 (a)–21, inclusive.*

§ 19.501–3 *Stock ownership requirement.* To meet the stock ownership requirement, it is necessary that at some time during the last half of the taxable year more than 50 percent in value of the outstanding stock of the corporation be owned, directly or indirectly, by or for not more than five individuals. For such purpose, the ownership of the stock must be determined as provided in section 503 and sections 19.503 (a)–1 to 19.503 (a)–7, inclusive, and section 19.503 (b)–1.

In the event of any change in the stock outstanding during the last half of the taxable year, whether in the number of shares or classes of stock, or whether in the ownership thereof, the conditions existing immediately prior and subsequent to each change must be taken into consideration.

In determining whether the statutory conditions with respect to stock ownership are present at any time during the last half of the taxable year, the phrase "in value" shall, in the light of all the circumstances, be deemed the value of the corporate stock outstanding at such time (not including treasury stock). This value may be determined upon the basis of the company's net worth, earning and dividend paying capacity, appreciation of assets, together with such other factors as have a bearing upon the value of the stock. If the value of the stock is greatly at variance with that reflected by the corporate books, the evidence of such value should be filed with the return. In any case where there are two or more classes of stock outstanding, the total value of all the stock should be allocated among the different classes according to the relative value of each class therein.

The rules stated in the last two preceding paragraphs are equally applicable in determining the stock ownership requirement specified in section 502 (e), relating to personal service contracts, and in section 502 (f), relating to the use of corporation property by a shareholder. The stock ownership requirement specified in these sections relates, however, to the stock outstanding at any time during the entire taxable year and not merely during the last half thereof.*

SEC. 502. PERSONAL HOLDING COMPANY INCOME.

For the purposes of this subchapter the term "personal holding company income" means the portion of the gross income which consists of:

(a) Dividends, interest (other than interest constituting rent as defined in subsection (g)), royalties (other than mineral, oil, or gas royalties), annuities.

(b) *Stock and securities transactions.* Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities.

(c) *Commodities transactions.* Gains from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange. This subsection shall not apply to gains by a producer, processor, merchant, or handler of the commodity which arise out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others.

(d) *Estates and trusts.* Amounts includible in computing the net income of the corporation under Supplement E of chapter 1; and gains from the sale or other disposition of any interest in an estate or trust.

(e) *Personal service contracts.* (1) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and (2) amounts received from the sale or other disposition of such a contract. This subsection shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

(f) *Use of corporation property by shareholder.* Amounts received as compensation (however designated and from whomsoever received) for the use of, or right to use, property of the corporation in any case where, at any time during the taxable year, 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property; whether such right is obtained directly from the corporation or by means of a sublease or other arrangement.

(g) *Rents.* Rents, unless constituting 50 per centum or more of the gross income. For the purposes of this subsection the term "rents" means compensation, however designated, for the use of, or right to use, property, and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation; but does not include amounts constituting personal holding company income under subsection (f).

(h) *Mineral, oil, or gas royalties.* Mineral, oil, or gas royalties, unless (1) constituting 50 per centum or more of the gross income, and (2) the deductions allowable under section 23 (a) (relating to expenses) other than compensation for personal services rendered by shareholders, constitute 15 per centum or more of the gross income.

§ 19.502–1 *Personal holding company income.* The term "personal holding company income" means the portion of the gross income which consists of the following:

(1) *Dividends.* The term "dividends" includes dividends as defined in section 115 (a), and amounts required to be included in gross income under section 337 (b). It does not include stock dividends (to the extent they do not constitute income to the shareholders within the meaning of the Sixteenth Amendment to the Constitution), liquidating dividends, or other capital distributions referred to in section 115 (c) and (d).

(2) *Interest (other than interest constituting rent).* The term "interest" means any amounts, includible in gross income, received for the use of money loaned except that it does not include interest constituting rent (see paragraph (10)).

(3) *Royalties (other than mineral, oil, or gas royalties).* The term "royalties" includes amounts received for the privilege of using patents, copyrights, secret processes and formulas, good will, trade marks, trade brands, franchises, and other like property. It does not include rents, or overriding royalties received by an operating company. As used in this paragraph the term "overriding royalties" means amounts received from the sublessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid.

(4) *Annuities.* The term "annuities" includes annuities only to the extent includible in the computation of gross income. (See section 22 (b) (2).)

(5) *Gains from the sale or exchange of stock or securities.* The term "gains from the sale or exchange of stock or securities" as used in section 502 (b) applies to all gains (including gains from liquidating dividends and other distributions from capital) from the sale or exchange of stock or securities includible in gross income. The term "stock or securities" as used in section 502 (b) includes shares or certificates of stock, or interest in any corporation (including any joint-stock company, insurance company, association, or other organization classified as a corporation by the Internal Revenue Code), certificates of interest or participation in any profit-sharing agreement, or in any oil, gas, or other mineral royalty, or lease, collateral trust certificates, voting trust certificates, stock rights or warrants, bonds, debentures, certificates of indebtedness, notes, car trust certificates, bills of exchange, obligations issued by or on behalf of a Government, State, Territory, or political subdivision thereof. In the case of "regular dealers in stock or securities" the term does not include gains derived from the sale or exchange of stock or securities made in the normal course of business. The term "regular dealer in stock or securities" means corporations with an established place of business regularly engaged in the purchase of stock or securities and their resale to customers, but such corporations are not dealers with respect to stock or securities held for speculation or investment.

(6) *Gains from futures transactions in commodities.* Gains from futures transactions in commodities include gains from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange, but do not include gains from cash transactions or gains by a producer, processor, merchant, or handler of the commodity, which arise out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others. In general, personal holding company income includes gains on futures contracts which are speculative. Futures contracts representing true hedges against price fluctuations in spot goods are not speculative transactions, though not concurrent with spot transactions. Futures contracts which are not hedges against spot transactions are speculative unless they are hedges against concurrent futures or forward sales or purchases.

(7) *Income from estates and trusts.* The income from estates and trusts which is to be included in personal holding company income consists of the income from estates and trusts which is required to be included in the gross income of the corporation under sections 161 to 169, inclusive, together with the gains derived by the corporation from the sale or other disposition of any interest in an estate or trust.

(8) *Amounts received under personal service contracts.* Amounts includible in personal holding company income as amounts received under personal service contracts consist of amounts received pursuant to a contract under which the corporation is to furnish personal services, and amounts received from a sale or other disposition of such a contract, if—

(a) some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

(b) at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services. For this purpose the stock ownership must be determined as provided in section 503 and sections 19.503 (a)–1 to 19.503 (a)–7, inclusive, section 19.503 (b)–1, and the last paragraph of section 19.501–3.

The application of section 502 (a) may be illustrated by the following examples:

Example (1). A, whose profession is that of an actor, owns all of the outstanding capital stock of the M Corporation. The M Corporation entered into a contract with A under which A was to perform personal services for the person or persons whom the M Corporation might designate, in consideration of which A was to receive $10,000 a year from the M Corporation. The M Corporation entered into a contract with the O Corporation in which A was designated to perform personal services for the O Corporation in consideration of which the O Corporation was to pay the M Corporation $500,000 a year. The $500,000 received by the M Corporation from the O Corporation constitutes personal holding company income.

Example (2). The N Corporation, the entire outstanding capital stock of which is owned by four individuals, is engaged in engineering. The N Corporation entered into a contract with the O Corporation to perform engineering services for the O Corporation, in consideration of which the O Corporation was to pay the N Corporation $50,000. The individual who was to perform the services was not designated (by name or by description) in the contract and no one but the N Corporation had the right to designate (by name or by description) such individual. The $50,000 received by the N Corporation from the O Corporation does not constitute personal holding company income.

(9) *Compensation for use of property.* The compensation for the use of, or the right to use, property of the corporation which is to be included in personal holding company income consists of amounts received as compensation (however designated and from whomsoever received) for the use of, or the right to use, property of the corporation in any case in which, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property, whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. The property may consist of a yacht, a city residence, a country house, or any other kind of property. See section 503 and sections 19.503 (a)–1 to 19.503 (a)–7, inclusive, section 19.503 (b)–1, and the last paragraph of section 19.501–3.

(10) *Rents (including interest constituting rent).* The rents which are to be included in personal holding company income consist of compensation, however designated, including charter fees, etc., for the use of, or the right to use, real property, or any other kind of property and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation, but do not include amounts constituting personal holding company income under section 502 (f) and paragraph (9) of this section. However, rents do not constitute personal holding company income if constituting 50 percent or more of the gross income of the corporation.

(11) *Mineral, oil, or gas royalties.* The income from mineral, oil, or gas royalties is to be included as personal holding company income, unless (A) the aggregate amount of such royalties constitutes 50 percent or more of the gross income of the corporation for the taxable year and (B) the aggregate amount of deductions allowable for expenses under section 23 (a) (other than compensation for personal services rendered by the shareholders of the corporation) equals 15 percent or more of the gross income of the corporation for the taxable year.

The term "mineral, oil, or gas royalties" means all royalties, except overriding royalties, received from any interest in mineral, oil, or gas properties. The term "mineral" includes the ores specified in paragraph (d) of section 19.23 (m)–1. As used in this paragraph the term "overriding royalties" means amounts received from the sublessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid.*

SEC. 503. STOCK OWNERSHIP.

(a) *Constructive ownership.* For the purpose of determining whether a corporation is a personal holding company, insofar as such determination is based on stock ownership under section 501 (a) (2), section 502 (e), or section 502 (f)—

(1) *Stock not owned by individual.* Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

(2) *Family and partnership-ownership.* An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For the purposes of this paragraph the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(3) *Options.* If any person has an option to acquire stock such stock shall be considered as owned by such person. For the purposes of this paragraph an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(4) *Application of family-partnership and option rules.* Paragraphs (2) and (3) shall be applied—

(A) For the purposes of the stock ownership requirement provided in section 501 (a) (2), if, but only if, the effect is to make the corporation a personal holding company;

(B) For the purposes of section 502 (e) (relating to personal service contracts), or of section 502 (f) (relating to the use of property by shareholders), if, but only if, the effect is to make the amounts therein referred to includible under such subsection as personal holding company income.

(5) *Constructive ownership as actual ownership.* Stock constructively owned by a person by reason of the application of paragraph (1) or (3) shall, for the purpose of applying paragraph (1) or (2), be treated as actually owned by such person; but stock constructively owned by an individual by reason of the application of paragraph (2) shall not be treated as owned by him for the purpose of again applying such paragraph in order to make another the constructive owner of such stock.

(6) *Option rule in lieu of family and partnership rule.* If stock may be considered as owned by an individual under either paragraph (2) or (3) it shall be considered as owned by him under paragraph (3).

§ 19.503 (a)–1 *Stock ownership.* For the purpose of determining whether—

(a) a corporation is a personal holding company, in so far as such determination is based on the stock ownership requirement specified in section 501 (a) (2) and section 19.501–3, or

(b) amounts received under a personal service contract or from the sale of such a contract constitute personal holding company income in so far as such determination is based on the stock ownership requirement specified in section 502 (e) and paragraph (8) of section 19.502–1, or

(c) compensation for the use of property constitutes personal holding company income in so far as such determination is based on the stock ownership requirement specified in section 502 (f) and paragraph (9) of section 19.502–1,

stock owned by an individual includes stock constructively owned by him as provided in section 503. For such purpose constructive ownership of stock shall be determined and applied in accordance with the rules provided in section 503 and sections 19.503 (a)–2 to 19.503 (a)–7, inclusive, and section 19.503 (b)–1. All forms and classes of stock, however denominated, which represent the interests of shareholders, members, or beneficiaries in the corporation shall be taken into consideration.*

§ 19.503 (a)–2 *Stock not owned by individual.* In determining the ownership of stock for any of the purposes set forth in section 19.503 (a)–1, stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries. For example, if A and B, two individuals, are the exclusive and equal beneficiaries of a trust or estate, and if such trust or estate owns the entire capital stock of the M Corporation, and if the M Corporation in turn owns the entire capital stock of the N Corporation, then the stock of both the M Corporation and the N Corporation shall be considered as being owned equally by A and B as the individuals owning the beneficial interest therein. See also section 19.503 (a)–6.*

§ 19.503 (a)–3 *Family and partnership ownership.* In determining the ownership of stock for any of the purposes set forth in section 19.503 (a)–1, an individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For the purposes of such determination the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

The application of the family and partnership rule in determining the ownership of stock for the purpose set forth in (a) of section 19.503 (a)–1 is illustrated by the following example:

Example: The M Corporation at some time during the last half of the taxable year had 1,800 shares of outstanding stock, 450 of which were held by various individuals having no relationship to one another and none of whom were partners, and the remaining 1,350 were held by 51 shareholders as follows:

Relationships	Shares		Shares		Shares		Shares		Shares	
An individual	A	100	B	20	C	20	D	20	E	20
His father	AF	10	BF	10	CF	10	DF	10	EF	10
His wife	AW	10	BW	40	CW	40	DW	40	EW	40
His brother	AB	10	BB	10	CB	10	DB	10	EB	10
His son	AS	10	BS	40	CS	40	DS	40	ES	40
His daughter by former marriage (son's half-sister)	ASHS	10	BSHS	40	CSHS	40	DSHS	40	ESHS	40
His brother's wife	ABW	10	BBW	10	CBW	10	DBW	160	EBW	10
His wife's father	AWF	10	BWF	10	CWF	110	DWF	10	EWF	10
His wife's brother	AWB	10	BWB	10	CWB	10	DWB	10	EWB	10
His wife's brother's wife	AWBW	10	BWBW	10	CWBW	10	DWBW	10	EWBW	110
Individual's partner	AP	10								

By applying the statutory rule provided in section 503 (a) (2) five individuals own more than 50 percent of the outstanding stock as follows:

A (including AF, AW, AB, AS, ASHS, AP)	160
B (including BF, BW, BB, BS, BSHS)	160
CW (including C, CS, CWF, CWB)	220
DB (including D, DF, DBW)	200
EWB (including EW, EWF, EWBW)	170
Total, or more than 50 percent	910

Individual A represents the obvious case where the head of the family owns the bulk of the family stock and naturally is the head of the group. A's partner owns 10 shares of the stock. Individual B represents the case where he is still head of the group because of the ownership of stock by his immediate family. Individuals C and D represent cases where the individuals fall in groups headed in C's case by his wife and in D's case by his brother because of the preponderance of holdings on the part of relatives by marriage. Individual E represents the case where the preponderant holdings of others eliminate that individual from the group.

The method of applying the family and partnership rule as illustrated in the foregoing example also applies in determining the ownership of stock for the purposes stated in (b) and (c) of section 19.503 (a)–1.*

§ 19.503 (a)–4 *Options.* In determining the ownership of stock for any of the purposes set forth in section 19.503 (a)–1, if any person has an option to acquire stock, such stock may be considered as owned by such person. The term "option" as used in this section includes an option to acquire such an option and each one of a series of such options, so that the person who has an option on an option to acquire stock may be considered as the owner of the stock.*

§ 19.503 (a)–5 *Application of family-partnership and option rules.* The family and partnership rule provided in section 503 (a) (2) and section 19.503 (a)–3 and the option rule provided in section 503 (a) (3) and section 19.503 (a)–4 shall be applied—

(a) for the purpose stated in (a) of section 19.503 (a)–1, if, but only if, the effect of such application is to make the corporation a personal holding company, or

(b) for the purpose stated in (b) of section 19.503 (a)–1, if, but only if, the effect of such application is to make the amounts received under a personal service contract or from the sale of such a contract personal holding company income, or

(c) for the purpose stated in (c) of section 19.503 (a)–1, if, but only if, the effect of such application is to make the

compensation for the use of property personal holding company income.

The family and partnership rule and the option rule must be applied independently for each of the purposes stated in section 19.503 (a)–1.*

§ 19.503 (a)–6 *Constructive ownership as actual ownership.* In determining the ownership of stock for any of the purposes set forth in section 19.503 (a)–1—

(a) stock constructively owned by a person by reason of the application of the rule provided in section 503 (a) (1), relating to stock not owned by an individual (see section 19.503 (a)–2) shall be considered as actually owned by such person for the purpose of again applying such rule or of applying the family and partnership rule provided in section 503 (a) (2) (see section 19.503 (a)–3) in order to make another person the constructive owner of such stock, and

(b) stock constructively owned by a person by reason of the application of the option rule provided in section 503 (a) (3) (see section 19.503 (a)–4) shall be considered as actually owned by such person for the purpose of applying either the rule provided in section 503 (a) (1), relating to stock not owned by an individual, or the family and partnership rule provided in section 503 (a) (2) in order to make another person the constructive owner of such stock, but

(c) stock constructively owned by an individual by reason of the application of the family and partnership rule provided in section 503 (a) (2) shall not be considered as actually owned by such individual for the purpose of again applying such rule in order to make another individual the constructive owner of such stock.

The application of this section may be illustrated by the following examples:

Example (1). A's wife, AW, owns all the stock of the M Corporation, which in turn owns all the stock of the O Corporation. The O Corporation in turn owns all the stock of the P Corporation.

Under the rule provided in section 503 (a) (1), relating to stock not owned by an individual, the stock in the P Corporation owned by the O Corporation is considered to be owned constructively by the M Corporation, the sole shareholder of the O Corporation. Such constructive ownership of the stock of the M Corporation is considered as actual ownership for the purpose of again applying such rule in order to make AW, the sole shareholder of the M Corporation, the constructive owner of the stock of the P Corporation. Similarly, the constructive ownership of the stock by AW is considered as actual ownership for the purpose of applying the family and partnership rule provided in section 503 (a) (2) in order to make A the constructive owner of the stock of the P Corporation, if such application is necessary for any of the purposes set forth in section 19.503 (a)–1. But the stock thus constructively owned by A may not be considered as actual ownership for the purpose of again applying the family and partnership rule in order to make another member of A's family, for example, A's father, the constructive owner of the stock of the P Corporation.

Example (2). B, an individual, owns all the stock of the R Corporation which has an option to acquire all the stock of the S Corporation, owned by C, an individual, who is not related to B.

Under the option rule provided in section 503 (a) (3) the R Corporation may be considered as owning constructively the stock of the S Corporation owned by C. Such constructive ownership of the stock by the R Corporation is considered as actual ownership for the purpose of applying the rule provided in section 503 (a) (1), relating to stock not owned by an individual, in order to make B, the sole shareholder of the R Corporation, the constructive owner of the stock of the S Corporation. The stock thus constructively owned by B by reason of the application of the rule provided in section 503 (a) (1) likewise is considered as actual ownership for the purpose, if necessary, of applying the family and partnership rule provided in section 503 (a) (2), in order to make another member of B's family, for example, B's wife, BW, the constructive owner of the stock of the S Corporation. However, the family and partnership rule could not again be applied so as to make still another individual the constructive owner of the stock of the S Corporation, that is, the stock constructively owned by BW could not be considered as actually owned by her in order to make BW's father the constructive owner of such stock by a second application of the family and partnership rule.*

§ 19.503 (a)–7 *Option rule in lieu of family and partnership rule.* If, in determining the ownership of stock for any of the purposes set forth in section 19.503 (a)–1, stock may be considered as constructively owned by an individual by an application of both the family-partnership rule provided in section 503 (a) (2) (see section 19.503 (a)–3) and the option rule provided in section 503 (a) (3) (see section 19.503 (a)–4) such stock shall be considered as owned constructively by the individual by reason of the application of the option rule.

The application of this section may be illustrated by the following example:

Example: Two brothers, A and B, each own 10 percent of the stock of the M Corporation, and A's wife, AW, also owns 10 percent of the stock of such corporation. AW's husband, A, has an option to acquire the stock owned by her at any time. It becomes necessary, for one of the purposes stated in section 19.503 (a)–1, to determine the stock ownership of B in the M Corporation.

If the family and partnership rule were the only rule that applied in the case, B would be considered, under that rule, as owning 20 percent of the stock of the M Corporation, namely, his own stock plus the stock owned by his brother. In that event, B could not be considered as owning the stock held by AW since (1) AW is not a member of B's family and (2) the constructive ownership of such stock by A through the application of the family and partnership rule in his case is not considered as actual ownership so as to make B the constructive owner by a second application of the same rule with respect to the ownership of the stock. (See section 19.503 (a)–6.)

However, there is more than the family and partnership rule involved in this example. As the holder of an option upon the stock, A may be considered the constructive owner of his wife's stock by the application of the option rule and without reference to the family relationship between A and AW. If A is considered as owning the stock of his wife by application of the option rule, then under section 19.503 (a)–6, such constructive ownership by A is regarded as actual ownership for the purpose of applying the family and partnership rule so as to make another member of A's family, for example, B, the constructive owner of the stock. Hence, since A may be considered as owning his wife's stock by applying both the family-partnership rule and the option rule, the provisions of section 503 (a) (6) apply and accordingly A must be considered the constructive owner of his wife's stock under the option rule rather than the family-partnership rule. B thus becomes the constructive owner of 30 percent of the stock of the M Corporation, namely, his own 10 percent, A's 10 percent, and AW's 10 percent constructively owned by A as the holder of an option on the stock.*

[SEC. 503. STOCK OWNERSHIP.]

(b) *Convertible securities.* Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be considered as outstanding stock—

(1) For the purpose of the stock ownership requirement provided in section 501 (a) (2), but only if the effect of the inclusion of all such securities is to make the corporation a personal holding company;

(2) For the purpose of section 502 (e) (relating to personal service contracts), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such subsection as personal holding company income; and

(3) For the purpose of section 502 (f) (relating to the use of property by shareholders), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such subsection as personal holding company income.

The requirement in paragraphs (1), (2), and (3) that all convertible securities must be included if any are to be included shall be subject to the exception that, where some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be included although the others are not included, but no convertible securities shall be included unless all outstanding securities having a prior conversion date are also included.

§ 19.503 (b)–1 *Convertible securities.* Under section 503 (b), outstanding secu-

rities of a corporation, such as bonds, debentures or other corporate obligations, convertible into stock of the corporation (whether or not convertible during the taxable year) shall be considered as outstanding stock of the corporation for the purpose of the stock ownership requirement provided in section 501 (a) (2), but only if the effect of such consideration is to make the corporation a personal holding company. Such convertible securities shall be considered as outstanding stock for the purpose of section 502 (e), relating to amounts received under personal service contracts, or of section 502 (f), relating to compensation for the use of property, but only if the effect of such consideration is to make the amounts therein referred to includible under such sections as personal holding company income. The consideration of convertible securities as outstanding stock is subject to the exception that, if some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be considered as outstanding stock although the others are not so considered, but no convertible securities shall be considered as outstanding stock unless all outstanding securities having a prior conversion date are also so considered. For example, if outstanding securities are convertible in 1939, 1940, and 1941, those convertible in 1939 can be properly considered as outstanding stock without so considering those convertible in 1940 or 1941, and those convertible in 1939 and 1940 can be properly considered as outstanding stock without so considering those convertible in 1941. However, the securities convertible in 1940 could not be properly considered as outstanding stock without so considering those convertible in 1939 and the securities convertible in 1941 could not be properly considered as outstanding stock without so considering those convertible in 1939 and 1940.*

SEC. 504. UNDISTRIBUTED SUBCHAPTER A NET INCOME.

For the purposes of this subchapter the term "undistributed subchapter A net income" means the subchapter A net income (as defined in section 505) minus—

(a) The amount of the dividends paid credit provided in section 27 (a) without the benefit of paragraphs (3) and (4) thereof (computed without its reduction, under section 27 (b) (1), by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations); but, in the computation of the dividends paid credit for the purposes of this subchapter, the amount allowed under subsection (c) of this section in the computation of the tax under this subchapter for any preceding taxable year shall be considered as a dividend paid in such preceding taxable year and not in the year of distribution; [See amendment of this subsection by section 228 of Revenue Act of 1939, set forth below.]

(b) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred prior to January 1, 1934, if such amounts are reasonable with reference to the size and terms of such indebtedness.

(c) Dividends paid after the close of the taxable year and before the 15th day of the third month following the close of the taxable year, if claimed under this subsection in the return, but only to the extent to which such dividends are includible, for the purposes of chapter 1, in the computation of the basic surtax credit for the year of distribution; but the amount allowed under this subsection shall not exceed either;

(1) The accumulated earnings and profits as of the close of the taxable year; or

(2) The undistributed subchapter A net income for the taxable year computed without regard to this subsection; or

(3) 10 per centum of the sum of—

(A) The dividends paid during the taxable year (reduced by the amount allowed under this subsection in the computation of the tax under this subchapter for the taxable year preceding the taxable year); and

(B) The consent dividends credit for the taxable year.

SEC. 228. COMPUTATION OF DIVIDEND CARRY-OVER FOR PERSONAL-HOLDING COMPANY TAX. (REVENUE ACT OF 1939.)

(a) Section 504 (a) of the Internal Revenue Code is amended by inserting before the semicolon at the end thereof a comma and the following: "and, in the computation of the dividend carry-over for the purposes of this subchapter, the term 'adjusted net income' as used in section 27 (c) means the adjusted net income minus the deduction allowed for Federal taxes under section 505 (a) (1)".

(b) The amendment made by subsection (a) shall be applicable to taxable years beginning after December 31, 1938.

§ 19.504–1 *Undistributed subchapter A net income.* The term "undistributed subchapter A net income" means the subchapter A net income (as defined in section 505 and section 19.505–1) minus (A) the amount of the dividends paid credit provided in section 27 (a) without the benefit of paragraph (3), relating to the deficit credit, and paragraph (4), relating to the debt credit, thereof (computed without its reduction, under section 27 (b) (1), by the amount of the credit provided in section 26 (a) relating to interest on certain obligations of the United States and Government corporations), (B) amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred prior to January 1, 1934, if such amounts are reasonable with reference to the size and the terms of such indebtedness (see section 19.504–2) and (C) dividends paid after the close of the taxable year and before the fifteenth day of the third month thereafter, if claimed under section 504 (c) in the return, but only to the extent and subject to the limitations contained in that section. In computing the dividends paid credit for the purposes of subchapter A of chapter 2, the amount allowed under section 504 (c) in the computation of the tax under subchapter A for any preceding taxable year is considered a dividend paid in such preceding taxable year and not in the year of distribution. In computing the dividend carry-over for the purposes of subchapter A of chapter 2, the term "adjusted net income" as used in section 27 (c) and section 19.27 (c)–1 means the adjusted net income minus the deductions allowed under section 505 (a) (1) for Federal taxes.*

§ 19.504–2 *Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred prior to January 1, 1934.*

(a) *Indebtedness.* The term "indebtedness" means an obligation, absolute and not contingent, to pay, on demand or within a given time, in cash or other medium, a fixed amount. The term "indebtedness" does not include the obligation of a corporation on its capital stock.

The indebtedness must have been incurred (or, if incurred by assumption, assumed) by the taxpayer prior to January 1, 1934. An indebtedness evidenced by bonds, notes or other obligations issued by a corporation is ordinarily incurred as of the date such obligations are issued and the amount of such indebtedness is the amount represented by the face value of the obligations. In the case of renewal or other changes in the form of an indebtedness, so long as the relationship of debtor and creditor continues between the taxpayer and his creditor, the giving of a new promise to pay by the taxpayer will not have the effect of changing the date the indebtedness was incurred.

(b) *Amounts used or irrevocably set aside.* The deduction is allowable, in any taxable year, only for amounts used or *irrevocably* set aside in that year. The use or irrevocable setting aside must be to effect the extinguishment or discharge of indebtedness. Since, therefore, in the case of renewal and other changes in the form of an indebtedness, the relationship of debtor and creditor continues between the taxpayer and his creditor, the mere giving of a new promise to pay by the taxpayer will not result in an allowable deduction. If amounts are set aside in one year, no deduction is allowable for such amounts for a later year in which actually paid. As long as all other conditions are satisfied, the aggregate amount allowable as a deduction for any taxable year includes all amounts (from whatever source) used and, as well, all amounts (from whatever source) *irrevocably* set aside, irrespective of whether in cash or other medium. Double deductions are not permitted.

(c) *Reasonableness of the amounts with reference to the size and terms of the indebtedness.* The reasonableness of the amounts used or *irrevocably* set aside must be determined by reference to the size and terms of the particular indebtedness. Hence, all the facts and circumstances with respect to the nature, scope, conditions, amount, maturity, and other terms of the particular indebtedness must be shown in each case.

Ordinarily an amount used to pay or retire an indebtedness, in whole or in part, at or prior to the maturity and in accordance with the terms thereof will be considered reasonable, and may be allowable as a deduction for the year in which so used, if no adjustment is required by reason of an amount set aside in a prior year for payment or retirement of the same indebtedness.

All amounts *irrevocably* set aside for the payment or retirement of an indebtedness in accordance with and pursuant to the terms of the obligation, for example, the annual contribution *to trustee* required by the provisions of a mandatory sinking fund agreement, will be considered as complying with the statutory requirement of reasonableness. To be considered reasonable it is not necessary that the plan of retirement provide for a retroactive setting aside of amounts for years prior to that in which the plan is adopted. However, if a voluntary plan was adopted prior to 1934, no adjustment is allowable in respect of the amounts set aside in the years prior to 1934.

(d) *General.* The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, the taxpayer must furnish the information required by the return, and such other information as the Commissioner may require in substantiation of the deduction claimed.*

SEC. 505. SUBCHAPTER A NET INCOME. For the purposes of this subchapter the term "Subchapter A Net Income" means the net income with the following adjustments:

(a) *Additional deductions.* There shall be allowed as deductions—

(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

(2) In lieu of the deduction allowed by section 23 (q), contributions or gifts, payment of which is made within the taxable year to or for the use of donees described in section 23 (q) for the purposes therein specified, to an amount which does not exceed 15 per centum of the taxpayer's net income, computed without the benefit of this paragraph and section 23 (q), and without the deduction of the amount disallowed under subsection (b) of this section.

(3) In the case of a corporation organized prior to January 1, 1936, to take over the assets and liabilities of the estate of a decedent, amounts paid in liquidation of any liability of the corporation based on the liability of the decedent to make contributions or gifts to or for the use of donees described in section 23 (o) for the purposes therein specified, to the extent such liability of the decedent existed prior to January 1, 1934. No deduction shall be allowed under paragraph (2) of this subsection for a taxable year for which a deduction is allowed under this paragraph.

(b) *Deductions not allowed.* The aggregate of the deductions allowed under section 23 (a), relating to expenses, and section 23 (l), relating to depreciation, which are allocable to the operation and maintenance of property owned or operated by the corporation, shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established (under regulations prescribed by the Commissioner with the approval of the Secretary) to the satisfaction of the Commissioner:

(1) That the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

(2) That the property was held in the course of a business carried on bona fide for profit; and

(3) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

SEC. 211. NET OPERATING LOSSES. (REVENUE ACT OF 1939.)

* * * * *

(i) *Denial of deduction to domestic personal holding companies.* Section 505 of the Internal Revenue Code (relating to definition of subchapter A net income) is amended by inserting at the end thereof the following:

"(c) *Net loss carry-over disallowed.* The deduction for net operating losses provided in section (s) shall not be allowed."

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SEC. 212. CORPORATION CAPITAL LOSSES. (REVENUE ACT OF 1939.)

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(d) *Capital losses of domestic personal holding companies.* Section 505 of the Internal Revenue Code (relating to definition of subchapter A net income) is amended by inserting at the end thereof the following new subsection:

"(d) *Capital losses.* The net income shall be computed without regard to section 117 (d) and (e), and losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges."

SEC. 229. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1939.) Except the amendments made by sections 211, 213, 214, 215, 217, 219, 220, 221, 222, 223, 226, 227, and 228 the amendments made by this title to the Internal Revenue Code shall be applicable only with respect to taxable years beginning after December 31, 1939.

§ 19.505–1 *Subchapter A net income.* The term "subchapter A net income" means, in the case of a domestic corporation, the gross income as defined in section 22 less the deductions provided in section 23 subject to the qualifications, limitations, and exceptions provided in section 505. In the case of a foreign corporation, whether resident or nonresident, which files or causes a return to be filed, the "subchapter A net income" means the net income from sources within the United States (gross income from sources within the United States as defined in section 119 and the regulations thereunder less statutory deductions) subject to the qualifications, limitations, and exceptions provided in section 505. In the case of a foreign corporation, whether resident or nonresident, which files no return the "subchapter A net income" means the gross income from sources within the United States as defined in section 119 and the regulations thereunder less the deductions enumerated in section 505 (a) but without the benefit of any deductions under chapter 1 (see section 233).

The "subchapter A net income" includes interest upon obligations of the United States and obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States, except as provided in section 22 (b) (4). The "subchapter A net income" does not include interest on obligations of States or Territories of the United States or any political subdivision thereof or of the District of Columbia or of the possessions of the United States.

The foreign tax credit permitted by section 131 with respect to the taxes imposed by chapter 1 is not allowed with respect to the surtax imposed by section 500. However, the deduction of foreign taxes under section 23 (c) is permitted for the purposes of the surtax even if for the purposes of the corporate tax imposed by chapter 1 a credit for such taxes is taken.

In addition to the qualifications, limitations, and exceptions provided in section 505 (a), a personal holding company is subject to the provisions of section 505 (b), (c), and (d) in the computation of its subchapter A net income. Section 505 (c) provides that the net operating loss deduction provided by section 23 (s) for taxable years beginning after December 31, 1939, shall not be allowed. Section 505 (d) limits the deduction for capital losses to $2,000 plus capital gains, for taxable years beginning after December 31, 1939, notwithstanding the provisions of section 117 (d) and (e), as amended, thus continuing for the purposes of the personal holding company tax the rule contained in section 117 (d) (1), prior to its amendment. Under section 505 (b) the aggregate of the deductions allowed under section 23 (a), relating to expenses, and section 23 (l), relating to depreciation, which are allocable to the operation and maintenance of property owned or operated by the company shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established to the satisfaction of the Commissioner:

(1) That the rent or other compensation received was the highest obtainable, or if none was received, that none was obtainable;

(2) That the property was held in the course of a business carried on bona fide for profit; and

(3) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

The burden of proof will rest upon the taxpayer to sustain the deduction claimed. If, in computing its subchapter A net income, a personal holding company claims deductions for expenses and depreciation allocable to the operation and maintenance of property owned or operated by the company, in an aggregate amount in excess of the rent or other compensation received for the use of, or the right to use, the property, it shall attach to its income tax return a statement setting forth its claim for allowance of the additional deductions together with a complete statement of the facts and circumstances pertinent to its claim and the arguments on which it relies. Such statement shall set forth:

(a) A description of the property;

(b) The cost or other basis to the corporation and the nature and value of the consideration paid for the property;

(c) The name and address of the person from whom acquired and the date thereof;

(d) The name and address of the person to whom leased or rented, or the person permitted to use the property, and the number of shares of stock, if any, held by such person and the members of his family;

(e) The nature and gross amount of the rent or other compensation received for the use of, or the right to use, the property during the taxable year and for each of the five preceding years and the amount of the expenses incurred with respect to, and the depreciation sustained on, the property for such years;

(f) Evidence that the rent or other compensation was the highest obtainable and, if none was received, a statement of the reasons therefor;

(g) A copy of the contract, lease or rental agreement;

(h) The purpose for which the property was used;

(i) The business carried on by the corporation with respect to which the property was held and the gross income, expenses and net income derived from the conduct of such business for the taxable year and for each of the five preceding years;

(j) A statement of any reasons which existed for expectation that the operation of the property would be profitable, or a statement of the necessity for the use of the property in the business of the corporation, and the reasons why the property was acquired; and

(k) Any other information pertinent to the taxpayer's claim.*

§ 19.505–2 *Illustration of computation of subchapter A net income, undistributed subchapter A net income, and surtax.* The method of computation of the subchapter A net income, the undistributed subchapter A net income, and the surtax under subchapter A of chapter 2 may be illustrated as follows:

The following facts exist with respect to the O Corporation, a personal holding company which is on the cash receipts and disbursements basis, for the calendar year 1939:

The net income, as computed under chapter 1, amounts to $190,000.

Federal income tax imposed by section 13 of the Revenue Act of 1938 was paid March 15, 1939, in the amount of $17,500.

Contributions or gifts payment of which is made to or for the use of donees described in section 23 (q) for the purposes therein specified amount to $35,000, of which $10,000 is deducted in arriving at the net income under chapter 1.

Rent in the amount of $10,000 was received from the principal shareholder of the corporation for the use of a country estate which had been previously acquired from such shareholder in exchange for its capital stock. The expenses of the corporation allocable to the maintenance and operation of the country estate amount to $30,000. The yearly depreciation on the depreciable property of the estate amounts to $5,000. The corporation has not established its right to claim the entire amount of the expenses and depreciation applicable to the estate as provided in section 505 (b) and section 19.505–1.

Dividends paid by the corporation to its shareholders during the taxable year which are allowable as a credit under section 27 (a) amount to $125,000.

The amount used during the year to pay indebtedness incurred by the corporation prior to January 1, 1934, is $31,750.

On March 1, 1940, the corporation paid its shareholders a taxable dividend of $15,000 and in its return, on Form 1120H, claimed a deduction for that amount under section 504 (c). Its accumulated earnings and profits as of the close of the taxable year 1939 were more than $15,000.

The subchapter A net income, the undistributed subchapter A net income, and the surtax are computed as follows:

Net income under chapter 1		$190,000
Add:		
Contributions deductible in computing net income under section 21		10,000
Aggregate of expenses and depreciation relating to the country estate in excess of the income derived therefrom		25,000
Net income computed without the benefit of a deduction for contributions and without the benefit of the amount disallowed under section 505 (b)		225,000
Less:		
Federal income tax	$17,500	
Contributions deductible under section 505 (a) (2) (15 percent of $225,000)	33,750	
		51,250
Subchapter A net income		173,750
Less:		
Dividends paid credit	$125,000	
Amount used to pay indebtedness	31,750	
		156,750
Undistributed subchapter A net income (before applying section 504 (c))		17,000
Dividends paid March 1, 1940 (subject to limitation in section 504 (c) (3))		12,500
Undistributed subchapter A net income		4,500
Amount taxable at 65 percent (not in excess of $2,000)		2,000
Amount taxable at 75 percent ($4,500 minus $2,000)		2,500
Surtax on $2,000 at 65 percent		1,300
Surtax on $2,500 at 75 percent		1,875
Total surtax		3,175

*

SEC. 506. DEFICIENCY DIVIDENDS—CREDITS AND REFUNDS.

(a) *Credit against unpaid deficiency.* If the amount of a deficiency with respect to the tax imposed by this subchapter for any taxable year has been established—

(1) by a decision of the Board of Tax Appeals which has become final; or

(2) by a closing agreement made under section 3760; or

(3) by a final judgment in a suit to which the United States is a party;

then a deficiency dividend credit shall be allowed against the amount of the deficiency so established and all interest, additional amounts, and additions to the tax provided by law not paid on or before the date when claim for a deficiency dividend credit is filed under subsection (d). The amount of such credit shall be 65 per centum of the amount of deficiency dividends, as defined in subsection (c), not in excess of $2,000, plus 75 per centum of the amount of such dividends in excess of $2,000; but such credit shall not exceed the portion of the deficiency so established which is not paid on or before the date of the closing agreement, or the date the decision of the Board or the judgment becomes final, as the case may be. Such credit shall be allowed as of the date the claim for deficiency dividend credit is filed.

(b) *Credit or refund of deficiency paid.* When the Commissioner has determined that there is a deficiency with respect to the tax imposed by this subchapter and the corporation has paid any portion of such asserted deficiency and it has been established—

(1) by a decision of the Board of Tax Appeals which has become final; or

(2) by a closing agreement made under section 3760; or

(3) by a final judgment in a suit against the United States for refund—

(A) if such suit is brought within six months after the corporation became entitled to bring suit, and

(B) if claim for refund was filed within six months after the payment of such amount;

that any portion of the amount so paid was the whole or a part of a deficiency at the time when paid, then there shall be credited or refunded to the corporation an amount equal to 65 per centum of the amount of deficiency dividends not in excess of $2,000, plus 75 per centum of the amount of such dividends in excess of $2,000, but such credit or refund shall not exceed the portion so paid by the corporation. Such credit or refund shall be made as provided in section 322 but without regard to subsection (b) or subsection (c) thereof. No interest shall be allowed on such credit or refund. No credit or refund shall be made under this subsection with respect to any amount of tax paid after the date of the closing agreement, or the date the decision of the Board or the judgment becomes final, as the case may be.

(c) *Deficiency dividends.*

(1) *Definition.* For the purpose of this subchapter, the term "deficiency dividends" means the amount of the dividends paid, on or after the date of the closing agreement or on or after the date the decision of the Board or the judgment becomes final, as the case may be, and prior to filing claim under subsection (d), which are includible, for the purposes of chapter 1, in the computation of the basic surtax credit for the year of distribution. No dividends shall be considered as deficiency dividends for the purposes of allowance of credit under subsection (a) unless (under regulations prescribed by the Commissioner with the approval of the Secretary) the corporation files, within thirty days after the date of the closing agreement, or the date upon which the decision of the Board or judgment becomes final, as the case may be, notification (which specifies the amount of the credit intended to be claimed) of its intention to have the dividends so considered.

(2) *Effect on dividends paid credit.*

(A) *For taxable year in which paid.* Deficiency dividends paid in any taxable year (to the extent of the portion thereof with respect to which the credit under subsection (a), or the credit or refund under subsection (b), or both, are allowed) shall be subtracted from the basic surtax credit for such year, but only for the purpose of computing the tax under this subchapter for such year and succeeding years.

(B) *For prior taxable year.* Deficiency dividends paid in any taxable year (to the extent of the portion thereof with respect to which the credit under subsection (a), or the credit or refund under subsection (b), or both are

allowed) shall not be allowed under section 504 (c) in the computation of the tax under this subchapter for any taxable year preceding the taxable year in which paid.

(d) *Claim required.* No deficiency dividends credit shall be allowed under subsection (a) and no credit or refund shall be made under subsection (b) unless (under regulations prescribed by the Commissioner with the approval of the Secretary) claim therefor is filed within sixty days after the date of the closing agreement, or the date upon which the decision of the Board or judgment becomes final, as the case may be.

(e) *Suspension of statute of limitations and stay of collection.*

(1) *Suspension of running of statute.* If the corporation files a notification, as provided in subsection (c), to have dividends considered as deficiency dividends, the running of the statute of limitations provided in section 275 or 276 on the making of assessments and the bringing of distraint or a proceeding in court for collection, in respect of the deficiency and all interest, additional amounts, and additions to the tax provided by law, shall be suspended for a period of two years after the date of the filing of such notification.

(2) *Stay of collection.* In the case of any deficiency with respect to the tax imposed by this subchapter established as provided in subsection (a)—

(A) The collection of the deficiency and all interest, additional amounts, and additions to the tax provided for by law shall, except in cases of jeopardy, be stayed until the expiration of thirty days after the date of the closing agreement, or the date upon which the decision of the Board or judgment becomes final, as the case may be.

(B) If notification has been filed, as provided in subsection (c), the collection of such part of the deficiency as is not in excess of either the credit allowable under subsection (a) or the amount which, in the notification, is specified as intended to be claimed as credit, shall, except in cases of jeopardy, be stayed until the expiration of sixty days after the date of the closing agreement, or the date upon which the decision of the Board or judgment becomes final, as the case may be.

(C) If claim for deficiency dividend credit is filed under subsection (d), the collection of such part of the deficiency as is not in excess of either the credit allowable under subsection (a) or the amount claimed, shall be stayed until the date the claim for credit is disallowed (in whole or in part), and if disallowed in part collection shall be made only of the part disallowed.

No distraint or proceeding in court shall be begun for the collection of an amount the collection of which is stayed under subparagraph (A), (B), or (C) during the period for which the collection of such amount is stayed.

(f) *Credit or refund denied if fraud, etc.* No deficiency dividend credit shall be allowed under subsection (a) and no credit or refund shall be made under subsection (b) if the closing agreement, decision of the Board, or judgment contains a finding that any part of the deficiency is due to fraud with intent to evade tax, or to failure to file the return under this subchapter within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure to file is due to reasonable cause and not due to willful neglect.

§ 19.506–1 *Purpose and scope of deficiency dividend credit.* Section 506 provides a method under which, by virtue of dividend distributions, a corporation may, under certain conditions (see section 19.506–3), be relieved from the payment of a deficiency in the surtax imposed by subchapter A of chapter 2 with respect to any taxable year beginning after December 31, 1938, or, if any portion of such deficiency has been paid, may be entitled, under certain conditions (see section 19.506–4), to a credit or refund of such portion. The deficiency must be established in the manner specified in section 506 (a) (1), (2), or (3) or section 506 (b) (1), (2), or (3) and the dividends must be paid on the date so established or within 60 days thereafter. For what constitutes payment of a dividend, see section 19.27 (b)–2.

The benefit of section 506 is not extended to the satisfaction of any interest, additional amounts, or additions to the tax provided by law with respect to the deficiency and such amounts remain payable as if that section had not been enacted. The benefit is denied if the closing agreement, decision of the Board, or judgment contains a finding that any part of the deficiency is due to fraud with intent to evade the tax, or to a failure to file a timely return without reasonable cause for such failure. See section 506 (f).*

§ 19.506–2 *Date when decision by Board or court becomes final and date of closing agreement.* The date upon which a decision by the Board of Tax Appeals becomes final is prescribed in section 1140 (paragraph 39 of the Appendix to these regulations).

The date upon which a judgment of a court becomes final must be determined upon the basis of the facts in the particular case. Ordinarily, a judgment of a United States district court becomes final upon the expiration of the time allowed for taking an appeal, if no such appeal is duly taken within such time; and a judgment of the United States Court of Claims becomes final upon the expiration of the time allowed for filing a petition for certiorari if no such petition is duly filed within such time.

The date of the closing agreement, made under section 3760 (see paragraph 46 of the Appendix to these regulations), is the date such agreement is approved by the Secretary, the Under Secretary, or an Assistant Secretary.*

§ 19.506–3 *Credit against unpaid deficiency.*

(a) *General.* If the amount of a deficiency with respect to the tax imposed by subchapter A of chapter 2 for any taxable year beginning after December 31, 1938, has been established as provided in section 506 (a) (1), (2), or (3), the corporation, under certain circumstances, is entitled to a deficiency dividends credit which, though it may not exceed the amount of the deficiency, is to be applied against the amount of such deficiency and all interest, additional amounts, and additions to the tax provided by law not paid on or before the date when the claim for a deficiency dividends credit is filed under section 506 (d). The amount of the deficiency dividends credit is 65 percent of the amount of "deficiency dividends" (as defined in section 506 (c) not in excess of $2,000 plus 75 percent of the amount of such dividends in excess of $2,000, and the allowance of the credit is subject to the following conditions, qualifications and limitations:

(1) The corporation is required under section 506 (c), within 30 days after the date of the closing agreement or the date upon which the decision of the Board or the judgment becomes final, to file a notice of its intention to claim a deficiency dividends credit, which notice shall specify the amount of the credit intended to be claimed;

(2) The corporation is required under section 506 (d), within 60 days after the date of the closing agreement or the date upon which the decision of the Board or judgment becomes final, to file a claim with respect to the credit for deficiency dividends;

(3) The deficiency dividends are required under section 506 (c) to be paid prior to the filing of the claim for a deficiency dividends credit and such dividends must be of such a nature as to constitute taxable dividends in the hands of such of the shareholders as are subject to taxation under chapter 1 for the year in which paid (see section 27 (i)) and must be nonpreferential (see section 27 (h)); and

(4) Under section 506 (a) the deficiency dividends credit shall not exceed the portion of the deficiency (not counting the interest, additional amounts, and additions to the tax, provided by law) which is not paid on or before the date of the closing agreement, or the date the decision of the Board or the judgment becomes final, as the case may be.

(b) *Form of notification.* The notice of intention to have dividends considered as deficiency dividends for the purposes of the allowance of credit under section 506 (a) shall be made, under oath or affirmation, on Form 975, copies of which, upon request, may be procured from any collector.

(c) *Contents of notification.* The notification shall, in accordance with the provisions of this section and the instructions on the form, set forth the following information:

(1) The name and address of the corporation;

(2) The place and date of incorporation;

(3) The amount of the unpaid deficiency with respect to the tax imposed by subchapter A of chapter 2: how it was established (closing agreement, Board decision or court judgment); the date thereof and the taxable year or years involved;

(4) The amount of the credit intended to be claimed as a deficiency dividends credit; and

(5) Such other information as may be required by the notification form.

(d) *Time and place of filing notification.* The notification required by section 506 (c) (1) and this section shall be filed with the Commissioner of Internal

Revenue, Washington, D. C., attention Income Tax Unit, Records Division, within 30 days after the date of the closing agreement, or the date upon which the decision of the Board or judgment becomes final, as the case may be.

(e) *Claim for deficiency dividends credit.* For claims for deficiency dividends credits, see section 19.506–5.*

§ 19.506–4 *Credit or refund of deficiency paid.* If the Commissioner has determined that there is a deficiency with respect to the tax imposed by subchapter A of chapter 2 for any taxable year beginning after December 31, 1938, and the corporation has paid any portion of such asserted deficiency, the corporation, under certain circumstances, is entitled to a credit or refund of such deficiency. The amount of the credit or refund is 65 percent of the amount of "deficiency dividends" (as defined in section 506 (c)) not in excess of $2,000, plus 75 percent of the amount of such dividends in excess of $2,000, and the allowance of the credit or refund is subject to the following conditions, qualifications and limitations:

(1) It must be established that the amount for which credit or refund is sought was the whole or a part of a deficiency at the time when paid, and such fact must be established as provided in section 506 (b) (1), (2), or (3);

(2) The corporation is required under section 506 (d), within 60 days after the date of the closing agreement or the date upon which the decision of the Board or the judgment becomes final, to file a claim for credit or refund;

(3) The "deficiency dividends" are required under section 506 (c) to be paid prior to the filing of the claim for credit or refund and such dividends must be of such a nature as to constitute taxable dividends in the hands of such of the shareholders as are subject to taxation under chapter 1 for the year in which paid (see section 27 (i)), and must be nonpreferential (see section 27 (h));

(4) The credit or refund shall not exceed the portion of the deficiency (not counting the interest, additional amounts, and additions to the tax, provided by law) which was paid by the corporation;

(5) The credit or refund shall be made as provided in section 322, but without regard to section 322 (b) (relating to the limitations on the allowance of refunds or credits), or section 322 (c) (relating to the effect of petitions to the Board on refunds or credits);

(6) No credit or refund shall be made under section 506 (b) with respect to any amount of tax paid after the date of the closing agreement, or the date the decision of the Board or the judgment becomes final, as the case may be; and

(7) No interest shall be allowed on the credit or refund.*

§ 19.506–5 *Claim for deficiency dividends credit or credit or refund.*

(a) *General.* A claim for a deficiency dividends credit under section 506 (a), relating to credit against unpaid deficiency, and under section 506 (b), relating to credit or refund of deficiency paid, must be filed within 60 days after the date of the closing agreement or the date upon which the decision of the Board or judgment becomes final, as the case may be.

(b) *Form of claim.* The claim for a deficiency dividends credit, or credit or refund, shall be made in duplicate, under oath or affirmation, on Form 976, copies of which, upon request, may be procured from any collector.

(c) *Contents of claim.* There shall be attached to and made a part of the claim a certified copy of the resolution of the board of directors, or other authority, authorizing the payment of the dividend with respect to which the claim is filed. In addition the claim shall, in accordance with the provisions of this section and the instructions on the form, set forth the following information:

(1) The name and address of the corporation;

(2) The place and date of incorporation;

(3) The amount of the deficiency determined with respect to the tax imposed by subchapter A of chapter 2 and the taxable year or years involved; the amount of the unpaid deficiency or, if the deficiency has been paid in whole or in part, the date of payment and the amount thereof; a statement as to how the deficiency was established, if unpaid, or if paid in whole or in part, how it was established that any portion of the amount paid was a deficiency at the time when paid and in either case whether it was by closing agreement, Board decision or court judgment and the date thereof; if established by a final judgment in a suit against the United States for refund, the date of payment of the deficiency, the date claim for refund was filed and the date the suit was brought; if established by a Board decision or court judgment a copy thereof shall be attached, together with an explanation of how the decision or judgment became final;

(4) The amount and date of payment of the dividend with respect to which the claim for deficiency dividends credit, or credit or refund, is filed;

(5) A statement setting forth the various classes of stock outstanding, the name and address of each shareholder, the class and number of shares held by each on the date of payment of the dividend with respect to which the claim is filed, and the amount of such dividend paid to each shareholder;

(6) The amount claimed as a deficiency dividends credit; and

(7) Such other information as may be required by the claim form.

(d) *Time and place of filing claim.* The claim required by section 506 (d) and this section shall be filed with the Commissioner of Internal Revenue, Washington, D. C., attention Income Tax Unit, Records Division, within 60 days after the date of the closing agreement, or the date upon which the decision of the Board or judgment becomes final, as the case may be.*

§ 19.506–6 *Effect of deficiency dividends on dividends paid credit.* No duplication of credit allowances with respect to any "deficiency dividends" is permitted. If a corporation claims and receives the benefit of the provisions of section 506 based upon a distribution of "deficiency dividends," that distribution does not become a part of the basic surtax credit for the purposes of subchapter A of chapter 2; nor is it made the basis of the 2½-month carry-back credit provided for in section 504 (c).*

§ 19.506–7 *Suspension of statute of limitations and stay of collection.*

(a) *Suspension of running of statute.* If a corporation files a notification of its intent to have certain dividends considered as "deficiency dividends" as provided in section 506 (c), then the running of the statute of limitations upon the assessment and collection of the established deficiency and all interest, additional amounts, and additions to the tax provided by law, is suspended for a period of two years after the date of the filing of such notification.

(b) *Stay of collection.* The Internal Revenue Code provides that, except in case of jeopardy, the collection of the established deficiency and all interest, additional amounts, and additions to the tax provided by law, is stayed for a period of 30 days subsequent to the final determination of the amount thereof. If within such 30-day period the corporation files with the Commissioner the prescribed notification of intention to seek the benefit of section 506, the collection of the established deficiency, to the extent of the amount of the credit specified by the corporation in such notification if not in excess of the amount allowable under section 506 (a), is, except in cases of jeopardy, stayed for a period of 60 days subsequent to the final determination of the amount thereof. The filing of a claim for a deficiency dividends credit under section 506 (d) effects a further stay of collection of that portion of the established deficiency covered by the claim if not in excess of the amount allowable under section 506 (a), until the date the claim is disallowed (in whole or in part) by the Commissioner. The Code further provides that where collection has been stayed as above indicated no distraint or proceeding in court shall be begun for the collection of the amount stayed during

the period for which it is stayed. The Commissioner, notwithstanding the provisions of section 272 (b), may refrain from assessing the subchapter A deficiency (plus interest, additional amounts, and additions to the tax) until the claim for the deficiency dividends credit is disposed of. After such claim is allowed or rejected, either in whole or in part, the entire amount of the deficiency (plus interest, additional amounts, and additions to the tax) will be assessed, if not already assessed. The amount of the claim for the deficiency dividends credit to the extent allowed will be credited against the amount so assessed, and the remainder of the amount assessed will be collected in the usual manner.*

SEC. 507. MEANING OF TERMS USED.

The terms used in this subchapter shall have the same meaning as when used in chapter 1.

SEC. 227. DEFINITION OF GROSS INCOME OF CERTAIN INSURANCE COMPANIES FOR PERSONAL HOLDING COMPANY TAX. (REVENUE ACT OF 1939.)

(a) Section 507 of the Internal Revenue Code is amended to read as follows:

"SEC. 507. MEANING OF TERMS USED.

"(a) *General rule.* The terms used in this subchapter shall have the same meaning as when used in chapter 1.

"(b) *Insurance companies other than life or mutual.* Notwithstanding subsection (a), the term 'gross income', as used in this subchapter, means, in the case of an insurance company other than life or mutual, the gross income, as defined in section 204 (b) (1), increased by the amount of losses incurred, as defined in section 204 (b) (6), and the amount of expenses incurred, as defined in section 204 (b) (7), and decreased by the amount deductible under section 204 (c) (7) (relating to tax-free interest)."

(b) *Taxable years to which applicable.* The amendments made by this section shall be applicable to taxable years beginning after December 31, 1938.

SEC. 508. ADMINISTRATIVE PROVISIONS.

All provisions of law (including penalties) applicable in respect of the taxes imposed by chapter 1, shall insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter, except that the provisions of section 131 shall not be applicable.

§ 19.508–1 *Return and payment of tax.* A separate return is required for the surtax imposed by section 500. Such returns shall be made on Form 1120H. In the case of a personal holding company which is a domestic corporation, the return is required to be made within the time provided by section 53 and in the case of a foreign corporation within the time provided in section 235. The tax shown by the corporation on its return must be paid in the case of a domestic corporation within the time provided in section 56 and in the case of a foreign corporation within the time provided in section 236. The same provisions of law relating to the period of limitations for assessment and collection which govern the taxes imposed by chapter 1 also apply to the surtax imposed under subchapter A of chapter 2. However, since the surtax imposed under subchapter A of chapter 2 is a distinct and separate tax from those imposed under chapter 1, the making of a return under chapter 1 will not start the period of limitations for assessment of the surtax imposed under subchapter A of chapter 2. If the corporation subject to section 500 fails to file a return the tax may be assessed at any time. If the Commissioner finds a deficiency in respect of the tax imposed by section 500, he is required to follow the same procedure which applies to deficiencies in income tax under chapter 1. The penalties applicable to the income taxes imposed under chapter 1, as well as the provisions of chapter 1 relating to interest and additions to the tax, also apply to the surtax imposed by section 500. The administrative provisions applicable to the surtax imposed by section 500 are not confined to those contained in chapter 1 but embrace all administrative provisions of law which have any application to income taxes.*

§ 19.508–2 *Determination of tax, assessment, collection.* The determination, assessment, and collection of the tax imposed by section 500, and the examination of returns and claims in connection therewith, will be made under such procedure as may be prescribed from time to time by the Commissioner.*

SEC. 509. IMPROPER ACCUMULATION OF SURPLUS.

For surtax on corporations which accumulate surplus to avoid surtax on shareholders, see section 102.

SEC. 510. FOREIGN PERSONAL HOLDING COMPANIES.

For provisions relating to foreign personal holding companies and their shareholders, see Supplement P of chapter 1.

SEC. 511. PUBLICITY OF RETURNS.

For provisions with respect to publicity of returns under this subchapter, see subsection (a) (2) of section 55.

SUBPART E—DEFINITIONS

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(1) *Person.* The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, company, or corporation.

(2) *Partnership and partner.* The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

(3) *Corporation.* The term "corporation" includes associations, joint-stock companies, and insurance companies.

(4) *Domestic.* The term "domestic" when applied to a corporation or a partnership means created or organized in the United States or under the law of the United States or of any State or Territory.

(5) *Foreign.* The term "foreign" when applied to a corporation or partnership means a corporation or partnership which is not domestic.

(6) *Fiduciary.* The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

(7) *Stock.* The term "stock" includes the share in an association, joint-stock company, or insurance company.

(8) *Shareholder.* The term "shareholder" includes a member in an association, joint-stock company, or insurance company.

(9) *United States.* The term "United States" when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

(10) *State.* The word "State" shall be construed to include the Territories and the District of Columbia, where such construction is necessary to carry out provisions of this title.

(11) *Secretary.* The term "Secretary" means the Secretary of the Treasury.

(12) *Commissioner.* The term "Commissioner" means the Commissioner of Internal Revenue.

(13) *Collector.* The term "collector" means collector of internal revenue.

(14) *Taxpayer.* The term "taxpayer" means any person subject to a tax imposed by this title.

(15) *Military or naval forces of the United States.* The term "military or naval forces of the United States" includes the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, and the Navy Nurse Corps, Female.

(16) *Withholding agent.* The term "withholding agent" means any person required to deduct and withhold any tax under the provisions of section 143 or 144.

(b) *Includes and including.* The terms "includes" and "including" when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined.

(c) *Cross references.* For other definitions, see the following:

Singular as including plural, R.S. 1 (U.S.C., Title 1, § 1).

Plural as including singular, R.S. 1 (U.S.C., Title 1, § 1).

Masculine as including feminine, R.S. 1 (U.S.C., Title 1, § 1).

Officer, R.S. 1 (U.S.C., Title 1, § 1).

Oath as including affirmation, R.S. 1 (U.S.C., Title 1, § 1).

Company or association as including successors and assigns, R.S. 5 (U.S.C., Title 1, § 5).

County as including parish, R.S. 2 (U.S.C., Title 1, § 2).

Vessel as including all means of water transportation, R.S. 3 (U.S.C., Title 1, § 3).

Vehicle as including all means of land transportation, R.S. 4 (U.S.C., Title 1, § 4.)

§ 19.3797–1 *Classification of taxables.* For the purpose of taxation the Internal Revenue Code makes its own classification and prescribes its own standards of classification. Local law is of no importance in this connection. Thus, a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See section 19.3797–3.) The term "partnership" is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. (See section 19.3797–4.) The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. (See sections 19.3797–2 and 19.3797–4.) The definitions, terms, and classifications, as set forth in section 3797, shall have the same respective meaning and scope in these regulations.*

§ 19.3797–2 *Association.* The term "association" is not used in the Internal

Revenue Code in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Code, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.*

§ 19.3797–3 *Association distinguished from trust.* The term "trust," as used in the Internal Revenue Code, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph there is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages. The nature and purpose of a cooperative undertaking will differentiate it from an ordinary trust. The purpose will not be considered narrower than that which is formally set forth in the instrument under which the activities of the trust are conducted.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Internal Revenue Code as a corporation. However, the fact that the capital or property of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form *itself*. The Internal Revenue Code disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust, or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.*

§ 19.3797–4 *Partnerships.* The Internal Revenue Code provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within the meaning of the Code, a trust, estate, or a corporation. On the other hand the Code classifies under the term "corporation" an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed period of its existence, and its management is centralized in one or more persons in their representative capacities, such an organization is an association, taxable as a corporation. As to the characteristics of an association, see also sections 19.3797–2 and 19.3797–3. The following examples will illustrate some phases of these distinctions:

(1) If A and B buy some acreage for the purpose of subdivision, they are joint adventurers, and the joint venture is classified by the Code as a partnership.

(2) A, B, and C contribute $10,000 each for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property and business of the enterprise, and the syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association.*

§ 19.3797–5 *Limited partnerships.* A limited partnership is classified for the purpose of the Internal Revenue Code as an ordinary partnership, or, on the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential characteristics, a limited partnership is to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law.

The Uniform Limited Partnership Act has been adopted in several States. A limited partnership organized under the provisions of that Act may be either an

association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.*

§ 19.3797–6 *Partnership associations.* A partnership association of the type authorized by the statutes of several States, such, for instance, as those of the State of Pennsylvania (Purdon's Penna. Stat. Ann., (Perm. Ed.), Title 59, ch. 3), having by virtue of the statutory provisions under which it was organized, the characteristics essential to an association within the meaning of the Internal Revenue Code, is taxable as a corporation.*

§ 19.3797–7 *Insurance company.* Insurance companies include both stock and mutual companies, as well as mutual benefit insurance companies. A voluntary unincorporated association of employees formed for the purpose of relieving sick and aged members and the dependents of deceased members is an insurance company, whether the fund for such purpose is created wholly by membership dues or partly by contributions from the employer. A corporation which merely sets aside a fund for the insurance of its employees is not required to file a separate return for such fund, but the income therefrom shall be included in the return of the corporation.

Though its name, charter powers and subjection to State insurance laws are significant in determining the business which a corporation is authorized and intends to carry on, the character of the business actually done in the taxable year determines whether it is taxable as an insurance company under the Internal Revenue Code. For example, during the year 1939 the M Corporation, incorporated under the insurance laws of the State of R, carried on the business of lending money in addition to guaranteeing the payment of principal and interest of mortgage loans. Of its total income for the year one-third was derived from its insurance business of guaranteeing the payment of principal and interest of mortgage loans and two-thirds was derived from its noninsurance business of lending money. The M Corporation is not an insurance company for the year 1939 within the meaning of the Code and these regulations.*

§ 19.3797–8 *Domestic, foreign, resident, and nonresident persons.* A domestic corporation is one organized or created in the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, or under the law of the United States or of any State or Territory, and a foreign corporation is one which is not domestic. A domestic corporation is a resident corporation even though it does no business and owns no property in the United States. A foreign corporation engaged in trade or business within the United States or having an office or place of business therein is referred to in these regulations as a resident foreign corporation, and a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, as a nonresident foreign corporation. A partnership engaged in trade or business within the United States or having an office or place of business therein is referred to in these regulations as a resident partnership, and a partnership not engaged in trade or business within the United States and not having any office or place of business therein, as a nonresident partnership. Whether a partnership is to be regarded as resident or nonresident is not determined by the nationality or residence of its members or by the place in which it was created or organized. The term "nonresident alien," as used in these regulations, includes a nonresident alien individual and a nonresident alien fiduciary.*

§ 19.3797–9 *Fiduciary.* "Fiduciary" is a term which applies to persons who occupy positions of peculiar confidence toward others, such as trustees, executors, and administrators. A fiduciary for income tax purposes is a person who holds in trust an estate to which another has the beneficial title or in which another has a beneficial interest, or receives and controls income of another, as in the case of receivers. A committee or guardian of the property of an incompetent person is a fiduciary.*

§ 19.3797–10 *Fiduciary distinguished from agent.* There may be a fiduciary relationship between an agent and a principal, but the word "agent" does not denote a fiduciary. An agent having entire charge of property, with authority to effect and execute leases with tenants entirely on his own responsibility and without consulting his principal, merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by a power of attorney, is not a fiduciary within the meaning of the Internal Revenue Code. In cases where no legal trust has been created in the estate controlled by the agent and attorney, the liability to make a return rests with the principal.*

SUBPART F—MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES

SEC. 3801. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.

(a) *Definitions.* For the purpose of this section—

(1) *Determination.* The term "determination under the income tax laws" means—

(A) A closing agreement made under section 3760;

(B) A decision by the Board of Tax Appeals or a judgment, decree, or other order by any court of competent jurisdiction, which has become final; or

(C) A final disposition by the Commissioner of a claim for refund. For the purposes of this section a claim for refund shall be deemed finally disposed of by the Commissioner—

(i) as to items with respect to which the claim was allowed, upon the date of allowance of refund or credit or upon the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(ii) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Commissioner in reduction of the refund or credit, upon expiration of the time for instituting suit with respect thereto (unless suit is instituted prior to the expiration of such time).

Such term shall not include any such agreement made, or decision, judgment, decree, or order which became final, or claim for refund finally disposed of, prior to August 27, 1938.

§ 19.3801 (a) (1)–1 *Purpose and scope of section 3801.* Section 3801 provides for correction of the effect of certain types of errors specified in section 3801 (b) and sections 19.3801 (b)–1 to 19.3801 (b)–5, inclusive, when one or more provisions of the internal revenue laws, such as the statute of limitations, would otherwise prevent such correction. Corrections are authorized under section 3801 only when the Commissioner, if the correction would result in an allowance of a refund or credit for the year with respect to which the error was made, or the taxpayer, if the correction would result in an additional assessment for such year, has maintained a position inconsistent with the error. No correction is permissible unless the inconsistent position is adopted by a determination made on or after August 27, 1938.*

§ 19.3801 (a) (1)–2 *Closing agreement as a determination.* For the purposes of section 3801, a determination may take the form of a closing agreement authorized by section 3760. (See paragraph 46 of the Appendix to these regulations.) Such an agreement may relate to the total tax liability of the taxpayer for a particular taxable year or years or to one or more separate items affecting such liability. If it becomes necessary or desirable to effect a determination in order to obtain or accelerate an adjustment authorized by section 3801, a closing agreement may be used for such purpose whenever a taxpayer and the Government have concurred in the disposition of an item or items. A closing agreement becomes final within the meaning of section 3801 on the date of its approval by the Secretary, the Under Secretary, or an Assistant Secretary.*

§ 19.3801 (a) (1)–3 *Decision by Board or court as a determination.* A determination may take the form of a decision by the Board of Tax Appeals or a judgment, decree, or other order by any court of competent jurisdiction, which has become final.

The date upon which a decision by the Board of Tax Appeals becomes final is prescribed in section 1140. (See paragraph 39 of the Appendix to these regulations.)

The date upon which a judgment of a court becomes final must be determined upon the basis of the facts in the particular case. Ordinarily, a judgment of a United States district court becomes final upon the expiration of the time allowed for taking an appeal, if no such appeal is duly taken within such time; and a judgment of the United States

Court of Claims becomes final upon the expiration of the time allowed for filing a petition for certiorari if no such petition is duly filed within such time.*

§ 19.3801 (a) (1)–4 *Final disposition of claim for refund as a determination.* A determination may take the form of a final disposition of a claim for refund. Such disposition may result in a determination with respect to two classes of items, i. e., items included by the taxpayer in a claim for refund and items applied by the Commissioner to offset the alleged overpayment. The time at which a disposition in respect of a particular item becomes final may depend not only upon what action is taken with respect to that item but also upon whether the claim for refund is allowed or disallowed.

(a) *Items with respect to which the taxpayer's claim is allowed.*

(1) The disposition with respect to an item as to which the taxpayer's contention in the claim for refund is sustained becomes final on the date of allowance of the refund or credit if—

(i) The taxpayer's claim for refund is unqualifiedly allowed; or

(ii) The taxpayer's contention with respect to an item is sustained and with respect to other items is denied, so that the net result is an allowance of refund or credit; or

(iii) The taxpayer's contention with respect to an item is sustained, but the Commissioner applies other items to offset the amount of the alleged overpayment and the items so applied do not completely offset such amount but merely reduce it so that the net result is an allowance of refund or credit.

(2) If the taxpayer's contention in the claim for refund with respect to an item is sustained but the Commissioner applies other items to offset the amount of the alleged overpayment so that the net result is a disallowance of the claim for refund, the date of mailing, by registered mail, of the notice of disallowance (see section 3772, set forth in paragraph 88 of the Appendix to these regulations) is the date of the final disposition as to the item with respect to which the taxpayer's contention is sustained.

(b) *Items with respect to which the taxpayer's claim is disallowed.* The disposition with respect to an item as to which the taxpayer's contention in the claim for refund is denied becomes final upon the expiration of the time allowed by section 3772 for instituting suit on the claim for refund, unless suit is instituted prior to the expiration of such period, if—

(i) The taxpayer's claim for refund is unqualifiedly disallowed; or

(ii) The taxpayer's contention with respect to an item is denied and with respect to other items is sustained so that the net result is an allowance of refund or credit; or

(iii) The taxpayer's contention with respect to an item is sustained in part and denied in part. For example, if the taxpayer claims a deductible loss of $10,000 and a consequent overpayment of $2,500 and the Commissioner concedes that a deductible loss was sustained but in the amount of $5,000 only, or that a deductible loss of $10,000 was sustained, but under the Commissioner's computation the consequent overpayment is only $2,000, the disposition of the claim for refund with respect to both the allowance of the $5,000 and the disallowance of the remaining $5,000, or the allowance of the $2,000 overpayment and the denial of the $500, becomes final upon the expiration of the time for instituting suit on the claim for refund unless suit is instituted prior to the expiration of such period.

(c) *Items applied by the Commissioner in reduction of the refund or credit.* If the Commissioner applies an item in reduction of the overpayment alleged in the claim for refund, and the net result is an allowance of refund or credit, the disposition with respect to the item so applied by the Commissioner becomes final upon the expiration of the time allowed by section 3772 for instituting suit on the claim for refund, unless suit is instituted prior to the expiration of such period. If such application of the item results in the assertion of a deficiency, such action does not constitute a final disposition by the Commissioner of a claim for refund within the meaning of section 3801 (a) (1) (C) (ii), but subsequent action taken with respect to such deficiency may result in a determination under section 3801 (a) (1) (A) or (B).

The necessity of waiting for the expiration of the 2-year period of limitations provided in section 3772 may be avoided in such cases as are described under (b) or (c) of this section by the use of a closing agreement to effect a determination.*

[SEC. 3801. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.]

[(a) *Definitions.* For the purpose of this section—]

(2) *Taxpayer.* Notwithstanding the provisions of section 3797 the term "taxpayer" means any person subject to a tax under the applicable Revenue Act.

(3) *Related taxpayer.* The term "related taxpayer" means a taxpayer who, with the taxpayer with respect to whom a determination specified in subsection (b) (1), (2), (3), or (4) is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance therein referred to was made, in one of the following relationships: (A) husband and wife; (B) grantor and fiduciary; (C) grantor and beneficiary; (D) fiduciary and beneficiary, legatee, or heir; (E) decedent and decedent's estate; or (F) partner.

§ 19.3801 (a) (3)–1 *Related taxpayer.* An adjustment in the case of the taxpayer with respect to whom the error was made may be authorized under section 3801 although the determination is made with respect to a different taxpayer, provided that such taxpayers stand in one of the relationships specified in section 3801 (a) (3). The concept of "related taxpayer" has application only to section 3801 (b) (1), (2), (3), or (4) and does not apply to section 3801 (b) (5). If such relationship exists, it is not essential that the error be with respect to a transaction possible only by reason of the existence of the relationship. For example, if the error with respect to which an adjustment is sought under section 3801 grew out of an assignment of rents between taxpayer A and taxpayer B, who are partners, and the determination is with respect to taxpayer A, an adjustment with respect to taxpayer B may be permissible despite the fact that the assignment had nothing to do with the business of the partnership. The relationship need not exist throughout the entire taxable year with respect to which the error was made, but only at some time during that taxable year. For example, if a taxpayer on February 15 assigns to his fiancee the net rents of a building which the taxpayer owns, and the two are married before the end of the taxable year, an adjustment may be permissible if the determination relates to such rents despite the fact that they were not husband and wife at the time of the assignment. See section 19.3801 (b)–8 for the requirement in certain cases that the relationship exist at the time an inconsistent position is first maintained.*

[SEC. 3801. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.]

(b) *Circumstances of adjustment.* When a determination under the income tax laws—

(1) Requires the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer; or

(2) Allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer; or

(3) Requires the exclusion from gross income of an item with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year or from the gross income of a related taxpayer; or

(4) Allows or disallows any of the additional deductions allowable in computing the net income of estates or trusts, or requires or denies any of the inclusions in the computation of net income of beneficiaries, heirs, or legatees, specified in section 162 (b) and (c) of chapter 1, and corresponding sections of prior revenue Acts, and the correlative inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or included, or disallowed, omitted, or allowed, as the case may be, in respect of the related taxpayer; or

(5) Determines the basis of property for depletion, exhaustion, wear and tear, or obsolescence, or for gain or loss on a sale or exchange, and in respect of any transaction upon which such basis depends there was an erroneous inclusion in or omission from the gross income of, or an erroneous recognition or nonrecognition of gain or loss to, the taxpayer or any person who acquired title to such property in such transaction and from whom mediately or immediately the taxpayer derived title subsequent to such transaction—

and, on the date the determination becomes final, correction of the effect of the error is prevented by the operation (whether before, on, or after May 28, 1938) of any provision of the internal-revenue laws other than this

section and other than section 3761 (relating to compromises), then the effect of the error shall be corrected by an adjustment made under this section. Such adjustment shall be made only if there is adopted in the determination a position maintained by the Commissioner (in case the amount of the adjustment would be refunded or credited in the same manner as an overpayment under subsection (c)) or by the taxpayer with respect to whom the determination is made (in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under subsection (c)), which position is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be. In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency, the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Board of Tax Appeals for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

§ 19.3801 (b)–0 *Circumstances of adjustment.* Section 3801 may be applied to correct the effect of an error if, on the date of the determination, correction of the effect of the error is prevented by the operation, whether before, on, or after May 28, 1938 (the date of enactment of the Revenue Act of 1938), of any provision of the internal revenue laws other than section 3801 and other than section 3761 of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts (relating to compromises—see paragraph 58 of the Appendix to these regulations). Examples of such provisions are: Sections 275, 311 (b) and (c), 322 (b) and (d), 1117 (e), 3746, and 3772 of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts (relating to periods of limitation—see paragraphs 30, 88, and 91 of the Appendix to these regulations); sections 272 (f) and 322 (c) of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts (relating to effect of petition to Board of Tax Appeals on further deficiency letters and on credits or refunds); section 3760 of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts (relating to closing agreements—see paragraph 46 of the Appendix to these regulations); and sections 3770 (a) (2), 3774, and 3775 of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts (relating to payments, refunds or credits after period of limitation has expired—see paragraphs 89, 90, and 92 of the Appendix to these regulations).

If the tax liability for the year with respect to which the error was made has been compromised under section 3761 of the Internal Revenue Code or the corresponding provisions of prior Revenue Acts, no adjustment may be made under section 3801 with respect to that year.

Section 3801 is not applicable if, on the date of the determination, correction of the effect of the error is permissible without recourse to such section.

The determination may be with respect to the tax imposed by chapter 1 and subchapters A, B, and D of chapter 2 of the Internal Revenue Code, by the corresponding provisions of any prior Revenue Acts, or by more than one of such provisions. Section 3801 may be applied to correct the effect of the error only as to the tax or taxes for the year with respect to which the error was made which correspond to the tax or taxes to which the determination relates. Thus, if the determination relates to the tax imposed by chapter 1 of the Internal Revenue Code, the adjustment may be only with respect to the tax imposed by such chapter or by the corresponding provisions of the Revenue Act applicable to the year with respect to which the error was made; if the determination relates to subchapter B of chapter 2 of the Internal Revenue Code, the adjustment may be only with respect to the tax imposed by such subchapter or by the corresponding provisions of the Revenue Act applicable to the year with respect to which the error was made.*

§ 19.3801 (b)–1 *Double inclusion of item of gross income.* Section 3801 (b) (1) applies if the determination requires the inclusion, in a taxpayer's gross income, of an item which was erroneously included in the gross income of the same taxpayer for another taxable year or of a related taxpayer for the same or another taxable year.

Example (1). A taxpayer who keeps his books on the cash basis erroneously included in his return for 1933 an item of accrued rent. In 1938, after the period of limitations on refunds for 1933 has expired, the Commissioner discovers that the taxpayer received this rent in 1934 and asserts a deficiency for the year 1934, which is sustained by the Board of Tax Appeals in 1941. An adjustment is authorized with respect to the year 1933. If the taxpayer had returned the rent for both 1933 and 1934 and by a determination was denied a refund claimed for 1934 on account of the rent item, a similar adjustment is authorized.

Example (2). A husband assigned to his wife salary to be earned by him in the year 1936. The wife included such salary in her separate return for that year and the husband omitted it. The Commissioner asserted a deficiency against the wife for 1936 with respect to a different item and she contested that deficiency before the Board of Tax Appeals. The wife would therefore be barred by section 322 (c) of the Revenue Act of 1936 from filing a claim for refund for 1936. Thereafter, the Commissioner asserts a deficiency against the husband on account of the omission of such salary from his return for 1936. The husband unsuccessfully contests the deficiency before the Board of Tax Appeals. An adjustment is authorized with respect to the wife's tax for 1936.*

§ 19.3801 (b)–2 *Double allowance of a deduction or credit.* Section 3801 (b) (2) applies if the determination allows the taxpayer a deduction or credit which was erroneously allowed the same taxpayer for another taxable year or a related taxpayer for the same or another taxable year.

Example (1). A taxpayer in his return for 1935 claimed and was allowed a deduction for destruction of timber by a forest fire. Subsequently it was discovered that the forest fire occurred in 1936 rather than in 1935. After the expiration of the period of limitations for the assessment of a deficiency for 1935, the taxpayer files a claim for refund for 1936 based upon a deduction for the fire loss in that year. The Commissioner allows the claim for refund. An adjustment is authorized with respect to the year 1935.

Example (2). The beneficiary of a testamentary trust in his return for 1933 claimed, and was allowed, a deduction for depreciation of the trust property. The Commissioner asserted a deficiency against the beneficiary for 1933 with respect to a different item and final decision of the Board of Tax Appeals was rendered in 1935, so that the Commissioner was thereafter barred by section 272 (f) of the Revenue Act of 1932 from asserting a further deficiency against the beneficiary for 1933. The trustee thereafter filed a timely refund claim contending that under the terms of the will the trust, and not the beneficiary, was entitled to the allowance for depreciation. The court in 1939 sustains the refund claim. An adjustment is authorized with respect to the beneficiary's tax for 1933.*

§ 19.3801 (b)–3 *Erroneous exclusion of item of gross income with respect to which tax was paid.* Section 3801 (b) (3) applies if the determination requires the exclusion, from a taxpayer's gross income, of an item with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the same taxpayer for another taxable year or of a related taxpayer for the same or another taxable year.

Example (1). A taxpayer received payments in 1936 under a contract for the performance of services and included the payments in his return for that year. A closing agreement was thereafter made with respect to the tax liability of the taxpayer for 1935. The taxpayer subsequently filed a claim for refund for the year 1936, asserting that he kept his books on the accrual basis and that, as the payments had accrued in 1935, they were properly taxable in that year. The claim for refund is allowed in 1939. An adjustment is authorized with respect to the year 1935. If the taxpayer had not included the payments in any return and the Commissioner had asserted a deficiency for 1936 with respect to the payments, and the deficiency is not sustained by the Board of Tax Appeals in its final decision in 1940, no adjustment

is authorized with respect to the year 1935. Although the determination requires the exclusion of the item from gross income, no tax had been paid with respect thereto. If the taxpayer, however, had paid the deficiency and thereafter successfully contested it before the Board or successfully sued for refund in court, an adjustment is authorized.

Example (2). A father and son conducted a partnership business, each being entitled to one-half of the net profits. The father included the entire net income of the partnership in his return for 1933 and the son included no portion of this income in his return for that year. Shortly before the expiration of the period of limitations with respect to deficiency assessments and refund claims for both father and son for 1933, the father filed a claim for refund of that portion of his 1933 tax attributable to the half of the partnership income which should have been included in the son's return. The court sustains the claim for refund in 1940. An adjustment is authorized with respect to the son's tax for 1933.*

§ 19.3801 (b)–4 *Correlative deductions and inclusions specified in section 162 (b) and (c) and corresponding provisions of prior Revenue Acts.* Section 3801 (b) (4) applies if the determination relates to the additional deduction specified in section 162 (b) and (c) of the Internal Revenue Code, or the corresponding provisions of a prior Revenue Act, for amounts distributable to the beneficiaries, heirs, or legatees of an estate or trust, and such determination requires:

(1) The allowance to the estate or trust of such additional deduction when such amounts have been erroneously omitted or excluded from the income of the beneficiaries, heirs, or legatees;

(2) The inclusion of such amounts in the income of the beneficiaries, heirs, or legatees when such additional deduction has been erroneously disallowed to or omitted by the estate or trust;

(3) The disallowance to an estate or trust of such additional deduction when such amounts have been erroneously included in the income of the beneficiaries, heirs, or legatees; or

(4) The exclusion of such amounts from the income of the beneficiaries, heirs, or legatees when such additional deduction has been erroneously allowed to the estate or trust.

The provisions of (1) of this section may be illustrated as follows:

Example: For the taxable year 1935, a trustee, directed by the trust instrument to accumulate the trust income, made no distribution to the beneficiary and returned the entire net income as taxable to the trust. Accordingly, the beneficiary did not include the trust income in his return for the year 1935. In 1937 a State court held invalid the clause directing accumulation. In 1939 the trustee, relying upon the court decision, files a claim for refund of the tax paid on behalf of the trust for the year 1935. The claim is sustained by the court in 1941, after the expiration of the period of limitations upon deficiency assessments against the beneficiary for the year 1935. An adjustment is authorized with respect to the beneficiary's tax for the year 1935.

The provisions of (2) of this section may be illustrated as follows:

Example: Assume the same facts as in the example under (1), except that, instead of the trustee's filing a refund claim, the commissioner, relying upon the decision of the State court, asserts a deficiency against the beneficiary for 1935. The deficiency is sustained by final decision of the Board of Tax Appeals in 1941, after the expiration of the period for filing claim for refund on behalf of the trust for 1935. An adjustment is authorized with respect to the trust for the year 1935.

The provisions of (3) of this section may be illustrated as follows:

Example: A trustee claimed in the return for 1935 a deduction for income distributed to the beneficiary. The income was included by the beneficiary in his return for 1935. In 1939 the Commissioner asserts a deficiency against the trust on the ground that the amount distributed to the beneficiary represented a charge against the corpus of the trust and did not constitute a distribution of income. The deficiency is sustained by final decision of the Board of Tax Appeals in 1941, after the expiration of the period for filing claims for refund by the beneficiary for 1935. An adjustment is authorized with respect to the beneficiary's tax for the year 1935.

The provisions of (4) of this section may be illustrated as follows:

Example: Assume the same facts as in the example under (3), except that, instead of the Commissioner's asserting a deficiency, the beneficiary files a refund claim for 1935 on the same ground. The claim is sustained by the court in 1941, after the expiration of the period of limitations upon deficiency assessments against the trust for 1935. An adjustment is authorized with respect to the trust for the year 1935.*

§ 19.3801 (b)–5. *Determination of basis of property in case of erroneous treatment of transaction relating to acquisition thereof.* Section 3801 (b) (5) applies if the determination establishes the basis of property for income tax purposes and in respect of the transaction upon which such basis depends there was an erroneous inclusion in or omission from gross income or an erroneous recognition or nonrecognition of gain or loss with respect to (1) the taxpayer with respect to whom the determination is made, or (2) any person who acquired title to such property in such transaction and the taxpayer with respect to whom the determination is made mediately or immediately derived title from such person subsequent to such transaction. Sec. 3801 (b) (5) applies with respect to the person who acquired the property and any subsequent transferees or donees who have a substituted basis ascertained by reference to the basis in the hands of such person. No adjustment is authorized with respect to the transferor of the property in the transaction upon which the basis of the property depends, when the determination is with respect to (1) the original transferee, or (2) a subsequent transferee of such original transferee.

Example (1). In 1933 taxpayer A transferred property which had cost him $5,000 to the X Corporation in exchange for an original issue of shares of its stock having a fair market value of $10,000. In his return for 1933 taxpayer A treated the exchange as one in which gain or loss was not recognizable:

(a) In 1939 the X Corporation claims that gain should have been recognized on the exchange in 1933 and therefore the property it received had a $10,000 basis for depreciation. Its contention is confirmed by a closing agreement. No adjustment is authorized with respect to the tax of the X Corporation for 1933, as there was no "erroneous inclusion in or omission from the gross income of, or an erroneous recognition or nonrecognition of gain or loss to" the X Corporation with respect to the exchange in 1933. Moreover no adjustment is authorized with respect to taxpayer A, as he is not the taxpayer with respect to whom the determination is made, nor does the determination relate to the property which taxpayer A acquired in the exchange in 1933, but, rather, to the property which he transferred in such exchange.

(b) In 1939 the X Corporation transfers the property to the Y Corporation in a tax-free exchange. In 1940 the Y Corporation sells the property and computes its profit on the basis of $10,000, which basis is sustained by the Board of Tax Appeals. No adjustment is authorized with respect to the Y Corporation or with respect to taxpayer A, for the reason stated in (a).

(c) In 1941 taxpayer A sells the stock which he had received in 1933 and claims that, as gain should have been recognized on the exchange in 1933, the basis for computing the profit on the sale is $10,000. His contention is confirmed in a closing agreement. An adjustment is authorized with respect to his tax for the year 1933, as the basis for computing gain on the sale depends upon the transaction in 1933 and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer" with respect to whom the determination is made.

(d) Taxpayer A does not sell the stock but makes a gift of it to taxpayer B, who later sells the stock and claims the $10,000 basis, which contention is confirmed in a closing agreement. An adjustment is authorized with respect to the tax of taxpayer A for 1933, as the basis for computing gain on the sale by taxpayer B depends upon the transaction in 1933 and in respect of that trans-

action there was erroneous nonrecognition of gain to taxpayer A, the "person who acquired title to such property in such transaction and from whom * * * immediately" taxpayer B, with respect to whom the determination is made, "derived title subsequent to such transaction."

Example (2). In 1934 taxpayer A sold property acquired at a cost of $5,000 to taxpayer B for $10,000. In his return for 1934 taxpayer A failed to include the profit on such sale. In 1939 taxpayer B sells the property for $12,000 and in his return for 1939 reports a gain of $2,000 upon the sale, which is confirmed in a closing agreement. No adjustment is authorized with respect to the tax of taxpayer A for 1934, as taxpayer A is not the taxpayer with respect to whom the determination is made; nor does the determination relate to property which taxpayer A acquired in the transaction in 1934, but rather to property which he transferred in such transaction.

Example (3). In 1933 a taxpayer received as additional compensation shares of stock in a corporation but did not include any amount in his return for that year on account of the receipt of such stock. In 1939, after the expiration of the period of limitations on deficiency assessments for 1933, he sells the stock for $15,000 and reports $5,000 in his return for 1939 as profit on the sale. A deficiency is asserted by the Commissioner on the theory that the basis is zero and the recognized gain is $15,000. The Board of Tax Appeals sustains the taxpayer's contention that the transaction was erroneously treated in 1933 in that the property then had a fair market valuation of $10,000. An adjustment is authorized with respect to the year 1933.

Example (4). In 1933 a taxpayer received 100 shares of stock of the X Corporation having a fair market value of $5,000, in exchange for shares of stock in the Y Corporation which he had acquired at a cost of $12,000. In his return for 1933 the taxpayer treated the exchange as one in which gain or loss was not recognizable. The taxpayer sold 50 shares of the X Corporation stock in 1934 and in his return for that year treated such shares as having a $6,000 basis. In 1939 the taxpayer sells the remaining 50 shares of stock of the X Corporation for $7,500 and reports $1,500 gain in his return for 1939. After the expiration of the period of limitations on deficiency assessments and on refund claims for 1933 and 1934, the Commissioner asserts a deficiency for 1939 on the ground that the loss realized on the exchange in 1933 was erroneously treated as nonrecognizable, and that the basis for computing gain upon the sale in 1939 is $2,500, resulting in a gain of $5,000. The deficiency is sustained by the Board of Tax Appeals in 1934. An adjustment is authorized with respect to the year 1933 as to the entire $7,000 loss realized on the exchange. No adjustment is authorized with respect to the year 1934 as the basis for computing gain upon the sale of the 50 shares in 1939 does not depend upon the transaction in 1934.*

§ 19.3801 (b)–6 *Law applicable in determination of error.* The question whether there was an erroneous inclusion, exclusion, omission, allowance, disallowance, recognition or nonrecognition is determined under the provisions of the internal revenue laws applicable with respect to the year as to which the inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, was made. The fact that the inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, was in pursuance of an interpretation, either judicial or administrative, accorded such provisions of the internal revenue laws at the time of such action is not necessarily determinative of this question. For example, if a later judicial decision authoritatively alters such interpretation so that such action was contrary to such provisions of the internal revenue laws as later interpreted, the inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, is erroneous within the meaning of section 3801.*

§ 19.3801 (b)–7 *Operation dependent upon maintenance of inconsistent position.*

(a) *Adjustments resulting in additional assessments.* An adjustment which would result in an additional assessment is authorized only if (1) *the taxpayer*, with respect to whom the determination is made, has, in connection therewith, maintained a position which is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, and (2) such inconsistent position is adopted in the determination.

Example (1). A taxpayer in his return for 1935 claimed and was allowed a deduction for loss arising from a casualty. After the taxpayer had filed his return for 1936 and after the period of limitations upon the assessment of a deficiency for 1935 had expired, it was discovered that the loss actually occurred in 1936. The taxpayer, therefore, filed a claim for refund for the year 1936 based upon the allowance of a deduction for the loss in that year, and the claim was allowed by the Commissioner. The taxpayer thus has maintained a position inconsistent with the allowance of the deduction for 1935 by filing a claim for refund for 1936 based upon the same deduction. As the determination—the allowance by the Commissioner of the claim for refund—adopts such inconsistent position, an adjustment is authorized for the year 1935.

An adjustment which would result in an additional assessment is not authorized if the Commissioner, and not the taxpayer, has maintained such inconsistent position.

Example (2). In example (1) above, assume that the taxpayer did not file a claim for refund for 1936 but the Commissioner issued a notice of deficiency for 1936 based upon other items. The taxpayer filed a petition with the Board of Tax Appeals and the Commissioner in his answer voluntarily proposed the allowance of a deduction for the loss previously allowed for 1935. The Board took the deduction into account in its redetermination of the tax for the year 1936. In such case no adjustment would be authorized for the year 1935 as the Commissioner, and not the taxpayer, has maintained a position inconsistent with the allowance of a deduction for the loss in that year.

(b) *Adjustments resulting in refund or credit.* An adjustment which would result in the allowance of a refund or credit is authorized only if (1) *the Commissioner*, in connection with a determination, has maintained a position which is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, and (2) such inconsistent position is adopted in the determination.

Example (1). A taxpayer who keeps his books on the cash basis erroneously included in his return for 1936 an item of accrued interest. After the period of limitations on refunds for 1936 had expired, the Commissioner asserted a deficiency for the year 1937 on the ground that the item of interest was received in 1937, and, therefore, was properly includible in gross income for that year. The taxpayer appealed to the Board of Tax Appeals, which sustained the deficiency. By asserting a deficiency for 1937 based upon the inclusion of the interest item in that year, the Commissioner has maintained a position inconsistent with the inclusion of the interest item in 1936. As the determination—the decision of the Board of Tax Appeals sustaining the deficiency—adopted such inconsistent position, an adjustment is authorized for the year 1936. An adjustment which would result in the allowance of a refund or credit is not authorized if the taxpayer with respect to whom the determination is made, and not the Commissioner, has maintained such inconsistent position.

Example (2). In example (1) above, assume that the Commissioner asserted a deficiency for 1937 based upon other items for that year, but in computing the net income upon which such deficiency was based did not include the item of interest. The taxpayer appealed to the Board of Tax Appeals and in his petition asserted that the interest item should be included in gross income for 1937. The Board included the item of interest in its redetermination of the tax

for the year 1937. In such case no adjustment would be authorized for 1936 as the taxpayer, and not the Commissioner, has maintained a position inconsistent with the erroneous inclusion of the item of interest in the gross income of the taxpayer for that year.*

§ 19.3801 (b)–8 *Existence of status of related taxpayer at time of the first maintenance of an inconsistent position.* No adjustment by way of a deficiency assessment shall be made with respect to a related taxpayer unless the relationship existed both in the taxable year with respect to which the error was made and at the time the taxpayer with respect to whom the determination is made first maintained, in the manner described in this section, the inconsistent position with respect to the taxable year to which the determination relates.

If the inconsistent position is maintained in a return, claim for refund, or petition (or amended petition) to the Board of Tax Appeals, for the taxable year in respect of which the determination is made, the requisite relationship must exist on the date of filing such document. If the inconsistent position is maintained in more than one of such documents, the requisite date is the date of filing of the document in which it was first maintained. If the inconsistent position was not thus maintained then the relationship must exist on the date of the determination, as, for example, where at the instance of the taxpayer a deduction is allowed, the right to which was not asserted in a return, claim for refund, or petition to the Board, and a determination is effected by means of a closing agreement.*

[SEC. 3801. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.]

(c) *Method of adjustment.* The adjustment authorized in subsection (b) shall be made by assessing and collecting, or refunding or crediting, the amount thereof, to be ascertained as provided in subsection (d), in the same manner as if it were a deficiency determined by the Commissioner with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year with respect to which the error was made, and as if on the date of the determination specified in subsection (b) one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year.

§ 19.3801 (c)–1 *Method of adjustment.* If the amount of the adjustment ascertained pursuant to section 3801 (d) represents an increase in tax, it is to be treated as if it were a deficiency determined by the Commissioner with respect to the taxpayer as to whom the error was made and for the taxable year with respect to which the error was made. The amount of the adjustment is thus to be assessed and collected under the law and regulations applicable to the assessment and collection of deficiencies, subject, however, to the limitations imposed by section 3801 (e). Notice of deficiency, unless waived, must be issued with respect to such amount and the taxpayer may contest the deficiency before the Board of Tax Appeals or, if he chooses, may pay the deficiency and later file claim for refund. If the amount of the adjustment ascertained pursuant to section 3801 (d) represents a decrease in tax, it is to be treated as if it were an overpayment claimed by the taxpayer with respect to whom the error was made for the taxable year with respect to which the error was made. Such amount may be recovered under the law and regulations applicable to overpayments of tax, subject, however, to the limitations imposed by section 3801 (e). The taxpayer must file a claim for refund thereof, unless the overpayment is refunded without such claim, and if the claim is denied or not acted upon by the Commissioner within the prescribed time, the taxpayer may then file suit for refund. The amount of the adjustment treated as if it were a deficiency or an overpayment, as the case may be, will bear interest and be subject to additions to the tax to the extent provided by the internal revenue laws applicable to deficiencies and overpayments for the taxable year with respect to which the error was made.

For the purpose of the adjustment authorized by section 3801, the period of limitation upon the making of an assessment or upon refund or credit for the taxable year with respect to which the error was made, as the case may be, shall be considered as if, on the date of the determination, one year remained before the expiration of such period, regardless of whether or not such period had expired prior to the date of the determination. The Commissioner thus has one year from the date of the determination within which to mail a notice of deficiency in respect of the amount of the adjustment where such amount is treated as if it were a deficiency. The issuance of such notice of deficiency, in accordance with the law and regulations applicable to the assessment of deficiencies, will suspend the running of the 1-year period of limitations provided by section 3801 (c). In accordance with the applicable law and regulations governing the collection of deficiencies (see section 276 (c) of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts), the period of limitation for collection of the amount of the adjustment will commence to run from the date of assessment of such amount. Similarly, the taxpayer has a period of one year from the date of the determination within which to file a claim for refund in respect of the amount of the adjustment where such adjustment is treated as if it were an overpayment. Where the amount of the adjustment is treated as if it were a deficiency and the taxpayer chooses to pay such deficiency and contest it by way of claim for refund, the period of limitation upon filing claim for refund will commence to run from the date of such payment (see section 322 (b) of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts).*

[SEC. 3801. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.]

(d) *Ascertainment of amount of adjustment.* In computing the amount of an adjustment under this section there shall first be ascertained the tax previously determined for the taxable year with respect to which the error was made. The amount of the tax previously determined shall be (1) the tax shown by the taxpayer, with respect to whom the error was made, upon his return for such taxable year, increased by the amounts previously assessed (or collected without assessment) as deficiencies, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or (2) if no amount was shown as the tax by such taxpayer upon his return, or if no return was made by such taxpayer, then the amounts previously assessed (or collected without assessment) as deficiencies, but such amounts previously assessed, or collected without assessment, shall be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax. There shall then be ascertained the increase or decrease in the tax previously determined which results solely from the correct exclusion, inclusion, allowance, disallowance, recognition, or nonrecognition, of the item, inclusion, deduction, credit, gain, or loss, which was the subject of the error. The amount so ascertained (together with any amounts wrongfully collected, as additions to the tax or interest, as a result of such error) shall be the amount of the adjustment under this section.

§ 19.3801 (d)–1 *Ascertainment of amount of adjustment.* The amount of the adjustment shall be ascertained as follows:

(1) The tax previously determined for the taxpayer as to whom the error was made, for the taxable year with respect to which the error was made, must first be ascertained. This may be the amount of tax shown on the taxpayer's return, but if any changes in that amount have been made they must be taken into account. In such cases the tax previously determined will be the tax shown on the return, increased by any amounts previously assessed (or collected without assessment) as deficiencies, and decreased by any amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax. If no amount was shown as the tax upon the return, or if no return was made, the tax previously determined will be the sum of the amounts previously assessed, or collected without assessment, as deficiencies, decreased by any amounts previously abated, credited, or otherwise repaid in respect of such tax.

The tax previously determined may consist of tax for any taxable year beginning after December 31, 1931, imposed by chapter 1 and subchapters A, B, and D of chapter 2 of the Internal Revenue Code, by the corresponding provisions of prior Revenue Acts, or by any one or more of such provisions.

(2) After the tax previously determined has been ascertained a recomputation must then be made to ascertain the increase or decrease in tax, if any, resulting from the correction of the error. The difference between the tax previously determined and the tax as recomputed after correction of the error will be the amount of the adjustment.

With the exception of the items upon which the tax previously determined was based and the item or items with respect to which the error was made, no other item shall be considered in computing the amount of the adjustment. If the treatment of any item upon which the tax previously determined was based, or if the application of any provisions of the internal revenue laws with respect to such tax, depends upon the amount of income (e. g., charitable contributions, foreign tax credit, earned income credit), readjustment in these particulars will be necessary as part of the recomputation in conformity with the change in the amount of the income which results from the correct treatment of the item or items in respect of which the error was made.

Any interest or additions to the tax collected as a result of the error shall be taken into account in determining the amount of the adjustment.

Example: For the taxable year 1936 a married man with no dependents, who kept his books on the cash receipts and disbursements basis, filed a return disclosing gross income of $42,000, deductions amounting to $12,000, and a net income of $30,000. Included among other items in the gross income were salary in the amount of $15,000 and rents accrued but not yet paid in the amount of $5,000. During the taxable year he donated $10,000 to the American Red Cross and in his return claimed a deduction of $5,294.12 on account thereof, representing the maximum deduction allowable under the 15 percent limitation imposed by section 23 (o), Revenue Act of 1936. In computing his net income he omitted interest income amounting to $6,000 and neglected to take a deduction for interest paid in the amount of $4,500. The return disclosed a tax liability of $3,565, which was assessed and paid. After the expiration of the period of limitations upon the assessment of a deficiency or the allowance of a refund for 1936, the Commissioner included the item of rental income amounting to $5,000 in the taxpayer's gross income for the year 1937 and asserted a deficiency for that year. As a result of a final decision of the Board of Tax Appeals sustaining the deficiency for 1937, an adjustment is authorized for the year 1936. The amount of the adjustment is computed as follows:

Tax previously determined for 1936	$3,565.00
Net income for 1936 upon which tax previously determined was based	30,000.00
Less: Rents erroneously included	5,000.00
Balance	25,000.00
Adjustment for contributions (add 15 percent of $5,000)	$750.00
Net income as adjusted	25,750.00
Tax as recomputed	2,646.50
Tax previously determined	3,565.00
Difference	918.50
Amount of adjustment to be refunded or credited	918.50

In accordance with the provisions of section 3801 (d), the recomputation to determine the amount of the adjustment does not take into consideration the item of $6,000 representing interest received, which was omitted from gross income, or the item of $4,500 representing interest paid, for which no deduction was allowed.*

[SEC. 3801. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.]

(e) *Adjustment unaffected by other items, etc.* The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this section, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error. Such amount, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item, inclusion, deduction, credit exemption, gain, or loss other than the one which was the subject of the error.

§ 19.3801 (e)–1 *Effect of other items on amount of adjustment.* The amount of the adjustment ascertained under section 3801 (d) shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, or gain or loss with respect to the year as to which the error was made.

Example (1). In the example set forth in section 19.3801 (d)–1, if, after the amount of the adjustment has been ascertained, the taxpayer filed a refund claim for the amount thereof, the Commissioner could not diminish the amount of that claim by offsetting against it the amount of tax which should have been paid with respect to the $6,000 interest item omitted from gross income for the year 1936; nor could the court, if suit were brought on such claim for refund, offset against the amount of the adjustment the amount of tax which should have been paid with respect to such interest.

Example (2). Assume that a taxpayer included in his gross income for the year 1936 an item which should have been included in gross income for the year 1935. After expiration of the period of limitations upon the assessment of a deficiency or the allowance of a refund for 1935 the taxpayer filed a claim for refund for the year 1936 on the ground that such item was not properly includible in gross income for that year. The claim for refund was allowed by the Commissioner and as a result of such determination an adjustment was authorized under section 3801 with respect to the tax for 1935. If, in such case, the Commissioner issued a notice of deficiency for the amount of the adjustment and the taxpayer contested the deficiency before the Board of Tax Appeals, the taxpayer could not in such proceeding claim an offset based upon his failure to take an allowable deduction for the year 1935; nor could the Board of Tax Appeals in its decision offset against the amount of the adjustment any overpayment for the year 1935 resulting from the failure to take such deduction.

If the Commissioner has refunded the amount of an adjustment under section 3801, the amount so refunded may not subsequently be recovered by the Commissioner in a suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss (other than the one which was the subject of the error) with respect to the year as to which the error was made.

Example (3). In the example set forth in section 19.3801 (d)–1, if the Commissioner had refunded the amount of the adjustment, no part of the amount so refunded could subsequently be recovered by the Commissioner by a suit for erroneous refund based on the ground that there was no overpayment for 1936, as the taxpayer had failed to include in gross income the $6,000 item of interest received in that year.

If the Commissioner has assessed and collected the amount of an adjustment, no part thereof may be recovered by the taxpayer in any suit for refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss (other than the one which was the subject of the error) with respect to the year as to which the error was made.

Example (4). In example (2) above, if the taxpayer had paid the amount of the adjustment, he could not subsequently recover any part of such payment in a suit for refund based upon his failure to take an allowable deduction for the year 1935.

If the amount of the adjustment is considered as an overpayment, it may be credited, under the applicable law and regulations thereunder, against any income or excess-profits tax, or installment thereof, due from the taxpayer. Likewise, if the amount of the adjustment is considered as a deficiency, any overpayment by the taxpayer of income or excess-profits tax may be credited against the amount of such adjustment in accordance with the applicable law and regulations thereunder. (See section 322 of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts.) Accordingly, it may be possible in one transaction between the Commissioner and the taxpayer to settle the taxpayer's tax liability for the year with respect to which the determination is made and to make the adjustment under section 3801 for the year with respect to which the error was made.*

[SEC. 3801. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.]

(f) *No adjustment for years prior to 1932.* No adjustment shall be made under this sec-

tion in respect of any taxable year beginning prior to January 1, 1932.

In pursuance of the Internal Revenue Code, applicable to income tax taxable years beginning after December 31, 1938, which was approved February 10, 1939, the foregoing regulations are hereby prescribed and Regulations 101, in so far as made applicable to the Internal Revenue Code by Treasury Decision 4885, and Treasury Decisions 4894, 4899, 4903, 4918, 4938, 4939, 4948, 4951, 4954, and 4957, in so far as they relate to income taxes for taxable years governed by the Internal Revenue Code, are hereby superseded.

[SEAL] GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved, January 29, 1940.

H. MORGENTHAU, Jr.,
Secretary of the Treasury.

[F. R. Doc. 40-470; Filed, January 30, 1940; 3:48 p. m.]

TITLE 46—SHIPPING

CHAPTER I—BUREAU OF MARINE INSPECTION AND NAVIGATION

[Order No. 17]

SUBCHAPTER K—SEAMEN

Section 131.1 *What vessels affected** is amended to read as follows:

All of the provisions of section 2 of the Seamen's Act of 1915, as amended, 46 U.S.C. Sup. 673, apply to all merchant vessels of the United States of more than one hundred tons gross, excepting those navigating rivers, harbors, lakes (other than Great Lakes), bays, sounds, bayous, and canals, exclusively and also, insofar as hours of labor on shipboard are concerned, to all tugs documented under the laws of the United States (except boats or vessels used exclusively for fishing purposes) navigating the Great Lakes, harbors of the Great Lakes and connecting and tributary waters between Gary, Indiana; Duluth, Minnesota; Niagara Falls, New York; and Ogdensburg, New York. The aforesaid section 2 does not apply to fishing or whaling vessels, yachts or to vessels engaged in salvage operations.

Section 131.2 *Division into three watches* is amended to read as follows:

On vessels to which all of the provisions of section 2 of the Seamen's Act of 1915, as amended, 46 U.S.C. Sup. 673, apply, the licensed officers, sailors, coal-passers, firemen, oilers and watertenders shall, while at sea, be divided into at least three watches, the number in each watch to be as nearly equal as the division of the total number in each class will permit. The watches shall be kept on duty successively. The requirement for division into watches applies only to those classes of the crew specifically named in the aforesaid section 2.

Section 131.4 *Local inspectors to note three-watch system in fixing complement of licensed officers and crew; licensed officers and crew of tugs and the barges engaged in voyages of less than 600 miles* is amended to read as follows:

Local inspectors will note that the 3-watch system extends to all licensed officers and to the sailors, coalpassers, firemen, oilers and watertenders of all vessels to which all of the provisions of section 2 of the Seamen's Act of 1915, as amended, 46 U.S.C. Sup. 673, apply and will be governed accordingly in fixing the complement of licensed officers and crew, as authorized by section 4463 R.S., as amended. The aforesaid section 2 does not, however, apply to the licensed officers and crew of tugs and barges when engaged in voyages of less than 600 miles except with regard to coalpassers, firemen, oilers, and watertenders. A voyage of less than 600 miles is construed as meaning the entire distance traversed in proceeding from the initial port of departure to the final port of destination, stops at intermediate ports while enroute not being considered as breaking the continuity of the voyage. Where changes in outstanding certificates of inspection are necessary they may be made by endorsement.

A new section, "131.5 *Eight-Hour Day,*" is to be added immediately following section 131.4, to read as follows:

No licensed officer or seaman in the deck or engine department of vessels to which all of the provisions of section 2 of the Seamen's Act of 1915, as amended, 46 U.S.C., Sup. 673, apply shall be required to be on duty more than eight hours in any one day except under the extraordinary conditions mentioned in the aforesaid section 2, nor shall any licensed officer or seaman in the deck or engine department of any tug documented under the laws of the United States (except boats or vessels used exclusively for fishing purposes) navigating the Great Lakes, harbors of the Great Lakes, and their connecting and tributary waters between Gary, Indiana; Duluth, Minnesota; Niagara Falls, New York; and Ogdensburg, New York, be required or permitted to be on duty more than eight hours in any one day, except in case of extraordinary emergency affecting the safety of the vessel and/or life or property. When the vessel is in a safe harbor, no seaman shall be required to do any unnecessary work on Sundays, New Year's Day, the Fourth of July, Labor Day, Thanksgiving Day, and Christmas Day, but this shall not prevent the dispatch of a vessel on regular schedule or when ready to proceed on her voyage.

A new section, "131.6 *Enforcement officers,*" is to be added immediately following section 131.5, to read as follows:

In addition to collectors of customs, who are specifically designated by law as enforcement officers, all field officers of the Bureau of Marine Inspection and Navigation of this Department are designated as enforcement officers for the purpose of seeing that the provisions of section 2 of the Seamen's Act of 1915, as amended, 46 U.S.C., Sup. 673, are complied with.

(Section 7 of the Act of June 25, 1936, 49 Stat. 1936; 46 U.S.C., Sup. 689)

[SEAL] J. M. JOHNSON,
Acting Secretary of Commerce.

[F. R. Doc. 40-500; Filed, February 2, 1940; 11:48 a. m.]

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*The amendment to sec. 2 of the Seamen's Act, 1915, contained in sec. 2 of the Act of June 25, 1936, 49 Stat., 1933, 46 U.S.C., Sup. IV, 673, has no application to fishing or whaling vessels or yachts. Insofar as Sec. 2, before amendment applied to fishing or whaling vessels or yachts it is still effective.

Notices

DEPARTMENT OF AGRICULTURE.

Division of Marketing and Marketing Agreements.

DETERMINATION OF THE SECRETARY OF AGRICULTURE, APPROVED BY THE PRESIDENT OF THE UNITED STATES, WITH RESPECT TO THE ISSUANCE OF ORDER NO. 4, AS AMENDED, REGULATING THE HANDLING OF MILK IN THE GREATER BOSTON, MASSACHUSETTS, MARKETING AREA

Whereas, H. A. Wallace, Secretary of Agriculture of the United States of America, pursuant to the powers conferred upon the Secretary by Public Act No. 10, 73d Congress, as amended, issued, effective February 9, 1936, Order No. 4[1] regulating the handling of milk in the Greater Boston, Massachusetts, marketing area, amendments to which order were issued pursuant to said act as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, effective August 1, 1937, and January 16, 1939; and

Whereas, the Secretary of Agriculture executed, effective January 16, 1939, a marketing agreement regulating the handling of milk in the Greater Boston, Massachusetts, marketing area; and

Whereas, the Secretary, having reason to believe that an amendment to said marketing agreement and to said order, as amended, would tend to effectuate the declared policy of the act, gave, on the 30th day of September 1939, notice[2] of a public hearing to be held at Concord, New Hampshire, on the 9th day of October 1939, and at Boston, Massachusetts, on the 10th day of October 1939, which hearing was held at Concord, New Hampshire, on the 9th day of October 1939, and at Boston, Massachusetts, on the 10th, 11th, 16th, and 17th days of October 1939, and at said times and places conducted public hearings at which all interested parties were afforded an op-

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[1] 4 F.R. 249 DI.
[2] 4 F.R. 4126 DI.

portunity to be heard on the proposed amendements to the marketing agreement and to the order, as amended; and

Whereas, after said hearings and after the tentative approval by the Secretary on January 19, 1940, of a marketing agreement, as amended, handlers of more than fifty percent of the volume of milk covered by such proposed Order No. 4, as amended, which is produced for sale in the Greater Boston, Massachusetts, marketing area, refused or failed to sign such tentatively approved marketing agreement, as amended, relating to milk:

Now, therefore, the Secretary of Agriculture, pursuant to the powers conferred upon him by Public Act No. 10, 73d Congress, as amended and as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, hereby determines:

(1) That the refusal or failure of said handlers to sign said tentatively approved marketing agreement, as amended, tends to prevent the effectuation of the declared policy of the act;

(2) That the issuance of the proposed Order No. 4, as amended, is the only practical means, pursuant to such policy, of advancing the interests of producers of milk which is produced for sale in said area; and

(3) That the issuance of the proposed Order No. 4, as amended, is approved or favored by over two-thirds of the producers who participated in a referendum conducted by the Secretary and who, during the month of May 1939, said month having been determined by the Secretary to be a representative period, were engaged in the production of milk for sale in said area.

In witness whereof, H. A. Wallace, Secretary of Agriculture of the United States, has executed this determination in duplicate and has hereunto set his hand and caused the official seal of the Department of Agriculture to be affixed hereto in the city of Washington, District of Columbia, this 29th day of January 1940.

[SEAL] H. A. WALLACE,
Secretary of Agriculture.

Approved:

FRANKLIN D ROOSEVELT
The President of the United States.

Dated, January 30, 1940.

[F. R. Doc. 40-495; Filed, February 1, 1940; 2:07 p. m.]

DETERMINATION OF THE SECRETARY OF AGRICULTURE, APPROVED BY THE PRESIDENT OF THE UNITED STATES, WITH RESPECT TO THE ISSUANCE OF AMENDMENT NO. 1 TO ORDER NO. 34 REGULATING THE HANDLING OF MILK IN THE LOWELL-LAWRENCE, MASSACHUSETTS, MARKETING AREA

Whereas, H. A. Wallace, Secretary of Agriculture of the United States of America, pursuant to the powers conferred upon the Secretary by Public Act No. 10, 73d Congress, as amended, and as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, issued, effective February 12, 1939, Order No. 34 [1] regulating the handling of milk in the Lowell-Lawrence, Massachusetts, marketing area; and

Whereas, the Secretary of Agriculture executed, effective February 12, 1939, a marketing agreement regulating the handling of milk in the Lowell-Lawrence, Massachusetts, marketing area; and

Whereas, the Secretary, having reason to believe that an amendment to said marketing agreement and to said order would tend to effectuate the declared policy of the act, gave, on the 30th day of September 1939, notice [2] of a public hearing to be held at Lowell, Massachusetts, on October 7, 1939, which hearing was held at Lowell, Massachusetts, on October 7, 1939, and at said time and place conducted a public hearing at which all interested parties were afforded an opportunity to be heard on the proposed amendments to the marketing agreement and to the order; and

Whereas, after said hearing and after the tentative approval by the Secretary on January 19, 1940, of a marketing agreement, as amended, handlers of more than fifty percent of the volume of milk covered by such proposed Order No. 34, as amended, which is produced for sale in the Lowell-Lawrence, Massachusetts, marketing area, refused or failed to sign such tentatively approved marketing agreement, as amended, relating to milk:

Now, therefore, the Secretary of Agriculture, pursuant to the powers conferred upon him by Public Act No. 10, 73d Congress, as amended and as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, hereby determines:

(1) That the refusal or failure of said handlers to sign said tentatively approved marketing agreement, as amended, tends to prevent the effectuation of the declared policy of the act;

(2) That the issuance of the proposed Amendment No. 1 to Order No. 34 is the only practical means, pursuant to such policy, of advancing the interests of producers of milk which is produced for sale in said area;

(3) That the issuance of the proposed Amendment No. 1 to Order No. 34 is approved or favored by over two-thirds of the producers who participated in a referendum conducted by the Secretary and who, during the month of May 1939, said month having been determined by the Secretary to be a representative period, were engaged in the production of milk in said area; and

(4) That the issuance of the proposed amendment to that provision in Order No. 34 requiring that all producers and associations of producers delivering milk to the same handler shall be paid uniform prices for all milk delivered to said handler is approved or favored by over three-fourths of the producers who participated in a referendum conducted by the Secretary separate and apart from the referendum referred to in the above paragraph and who, during the month of May 1939, said month having been determined by the Secretary to be a representative period, were engaged in the production of milk in said area.

In witness whereof, H. A. Wallace, Secretary of Agriculture of the United States, has executed this determination in duplicate and has hereunto set his hand and caused the official seal of the Department of Agriculture to be affixed hereto in the city of Washington, District of Columbia, this 29th day of January 1940.

[SEAL] H. A. WALLACE,
Secretary of Agriculture.

Approved:

FRANKLIN D ROOSEVELT
The President of the United States.

Dated, January 30, 1940.

[F. R. Doc. 40-493; Filed, February 1, 1940; 2:06 p. m.]

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[1] 4 F.R. 601 DI.
[2] 4 F.R. 4127 DI.

DEPARTMENT OF LABOR.

Wage and Hour Division.

IN THE MATTER OF EXEMPTION OF THE RAW FUR RECEIVING INDUSTRY AS A SEASONAL INDUSTRY

Whereas, a duly authorized representative of the Administrator, after a public hearing, has made the following finding and determination:

1. The legal trapping season in the United States and Canada varies with different animals and from state to state or province to province, and may be longer or shorter than the season in which the pelts are prime but, in any event, the natural season, when the pelts are prime, does not exceed six months. Except for an insubstantial amount, probably less than 5 percent of the total, all the new catch of fur is taken and shipped from the country to the raw fur receiving houses between December 1 and April 1 each year.

2. The raw furs are received each year in the chief fur trading centers, of which New York and St. Louis are the most important, during the trapping season, i. e., from December 1 to April 1, by employers known in the trade as raw fur "receiving houses." In these houses the furs are immediately graded, and, when necessary, scraped and dried. The prompt initial grading is necessary: (1) to set a basis for payment to the trapper or collector, and (2) to determine which skins need scraping and drying for preservation. Skins that have not been properly

scraped and dried are perishable; dried skins are not perishable.

3. The majority of the furs received are also sold by the receiving houses during the period December 1 to April 1, but some skins are sold during the balance of the year. Aside from these sales, and aside from an insubstantial amount of trading in dried raw furs as dealers with other dealers and receivers, the receiving houses cease operation on or about April 1 each year because the materials they handle, i. e., the annual domestic catch of fur, are no longer available in the form in which they must be handled, i. e., as new prime pelts requiring inspection and, in many cases, scraping and drying, until the following December 1 or thereabouts, because of climate and other natural factors.

4. The business of the raw fur receiving houses constitutes a specialized function not performed by other fur dealers or processors, with specialized employees and the raw fur receiving industry is a branch of an industry of a seasonal nature within the meaning of Section 7 (b) (3) of the Act and Part 526 of Regulations issued thereunder.

5. "Raw fur receiving houses" as used herein shall include all employers who (a) receive all or almost all their furs from country sources, i. e., trappers, farmers, and country collectors and dealers, and (b) engage in the operations of scraping and drying, as well as operations incidental thereto.

6. The term "raw fur receiving industry" as used herein shall include the receiving, scraping, drying and grading, in raw fur receiving houses, of domestic furs received from country sources and operations immediately incidental thereto.

7. The term "domestic furs" as used herein shall include United States and Canadian furs.

Whereas a notice of opportunity to petition for review of the said finding and determination was published in the FEDERAL REGISTER on January 12, 1940;[1] and

Whereas no petition for review has been filed within the fifteen days allowed under Section 526.7 of the Administrator's Regulations applicable to industries of a seasonal nature, as amended (Title V, Chapter 29, Part 526, Code of Federal Regulations);

Now, therefore, pursuant to the provisions of said Section 526.7 of the said Regulations, the exemption provided by Section 7 (b) (3) of the Fair Labor Standards Act of 1938 will become effective on the date this notice embodying the above-quoted finding and determination appears in the FEDERAL REGISTER. The said exemption is applicable only as specified by the aforesaid finding and determination.

[1] 5 F.R. 179 DI.

Signed at Washington, D. C. this 2nd day of February 1940.

HAROLD D. JACOBS,
Administrator.

[F. R. Doc. 40–508; Filed, February 2, 1940; 12:56 p. m.]

FEDERAL TRADE COMMISSION.

United States of America—Before Federal Trade Commission

At a regular session of the Federal Trade Commission, held at its office in the City of Washington, D. C., on the 30th day of January, A. D. 1940.

Commissioners: Ewin L. Davis, Chairman; Garland S. Ferguson, Charles H. March, William A. Ayres, Robert E. Freer.

[Docket No. 3773]

IN THE MATTER OF MEYER R. EISENBROCK, INDIVIDUALLY, AND TRADING AS MARHAR SALES COMPANY

ORDER APPOINTING EXAMINER AND FIXING TIME AND PLACE FOR TAKING TESTIMONY

This matter being at issue and ready for the taking of testimony, and pursuant to authority vested in the Federal Trade Commission, under an Act of Congress (38 Stat. 717; 15 U.S.C.A., Section 41),

It is ordered, That Randolph Preston, an examiner of this Commission, be and he hereby is designated and appointed to take testimony and receive evidence in this proceeding and to perform all other duties authorized by law;

It is further ordered, That the taking of testimony in this proceeding begin on Monday, February 26, 1940, at eleven o'clock in the forenoon of that day (eastern standard time) in Room 110, Federal Building, Second and Chestnut Streets, Philadelphia, Pennsylvania.

Upon completion of testimony for the Federal Trade Commission, the examiner is directed to proceed immediately to take testimony and evidence on behalf of the respondent. The examiner will then close the case and make his report upon the evidence.

By the Commission.

[SEAL] OTIS B. JOHNSON,
Secretary.

[F. R. Doc. 40–498; Filed, February 2, 1940; 10:11 a. m.]

United States of America—Before Federal Trade Commission

At a regular session of the Federal Trade Commission, held at its office in the City of Washington, D. C., on the 30th day of January, A. D. 1940.

Commissioners: Ewin L. Davis, Chairman; Garland S. Ferguson, Charles H. March, William A. Ayres, Robert E. Freer.

[Docket No. 3982]

IN THE MATTER OF FREDMORR, INC., A CORPORATION, AND MORRIS WEITZ, INDIVIDUALLY, AND TRADING AS MORRCO, AND AS AN OFFICER OF FREDMORR, INC.

ORDER APPOINTING EXAMINER AND FIXING TIME AND PLACE FOR TAKING TESTIMONY

This matter being at issue and ready for the taking of testimony, and pursuant to authority vested in the Federal Trade Commission, under an Act of Congress (38 Stat. 717; 15 U.S.C.A., Section 41),

It is ordered, That Randolph Preston, an examiner of this Commission, be and he hereby is designated and appointed to take testimony and receive evidence in this proceeding and to perform all other duties authorized by law;

It is further ordered, That the taking of testimony in this proceeding begin on Thursday, February 29, 1940, at ten o'clock in the forenoon of that day (eastern standard time) in Room 500, 45 Broadway, New York, New York.

Upon completion of testimony for the Federal Trade Commission, the examiner is directed to proceed immediately to take testimony and evidence on behalf of the respondent. The examiner will then close the case and make his report upon the evidence.

By the Commission.

[SEAL] OTIS B. JOHNSON,
Secretary.

[F. R. Doc. 40–499; Filed, February 2, 1940; 10:11 a. m.]

SECURITIES AND EXCHANGE COMMISSION.

United States of America—Before the Securities and Exchange Commission

At a regular session of the Securities and Exchange Commission, held at its office in the City of Washington, D. C., on the 30th day of January, A. D. 1940.

[File Nos. 51–28, 51–37]

IN THE MATTER OF INTERNATIONAL UTILITIES CORPORATION

ORDER FOR APPROVAL OF PAYMENT

International Utilities Corporation, a registered holding company, having filed applications pursuant to Section 12 (c) of the Public Utility Holding Company Act of 1935 and Rule U–12C–2 adopted thereunder, for approval of the declaration and payment out of capital or unearned surplus of a regular quarterly dividend at the rate of 87½¢ per share on the $3.50 Prior Preferred Stock, and a payment of 43¾¢ per share on the $1.75 Preferred Stock on account of accumulated unpaid dividends;

Hearings on such applications having been held after appropriate notice; the said matters having been consolidated

for purposes of the record; the record in this matter having been examined; and the Commission having made and filed its findings herein:

It is ordered, That the proposed payment of the dividends to the $3.50 Prior Preferred Stock be approved, subject, however, to the following conditions:

(1) That the proposed dividends on the $3.50 Prior Preferred Stock shall be charged to capital surplus, and that the amount of such dividends so charged shall be restored to capital surplus from the first available earnings after December 31, 1938, after providing for 1939 dividends heretofore declared and paid;

(2) That International Utilities Corporation shall notify the $3.50 Prior Preferred stockholders concurrently with the receipt of dividends that the dividend payment received is subject to the above condition; and,

(3) That the Commission reserve jurisdiction as to its approval of the declaration and payment of the proposed dividend to the $1.75 Preferred Stock.

By the Commission.

[SEAL] FRANCIS P. BRASSOR,
Secretary.

[F. R. Doc. 40-501; Filed, February 2, 1940; 12:25 p. m.]

United States of America—Before the Securities and Exchange Commission

At a regular session of the Securities and Exchange Commission, held at its office in the City of Washington, D. C., on the 30th day of January, A. D. 1940.

[File No. 56-75]

IN THE MATTER OF CONSOLIDATED ELECTRIC AND GAS COMPANY

ORDER PERMITTING WITHDRAWAL OF APPLICATION

Consolidated Electric and Gas Company, a registered holding company, having filed an application and amendments thereto pursuant to Rule U-12D-1, promulgated under Section 12 (d) of the Public Utility Holding Company Act of 1935, for approval of the sale of 2,000 shares of common capital stock of no par value, and $209,000 principal amount of First Mortgage 5½% Gold Bonds due July 1, 1987, of its subsidiary, Citizens Gas Company (Pennsylvania), the same being all of the issued and outstanding securities of that company, to Bioren & Co., of Philadelphia, Pennsylvania;

The applicant having requested permission to withdraw the said application, the Commission, being fully advised in the premises, hereby consents to the withdrawal of the said application and to that effect

It is so ordered.

By the Commission.

[SEAL] FRANCIS P. BRASSOR,
Secretary.

[F. R. Doc. 40-502; Filed, February 2, 1940; 12:25 p. m.]

United States of America—Before the Securities and Exchange Commission

At a regular session of the Securities and Exchange Commission held at its office in the City of Washington, D. C., on the 2d day of February, A. D. 1940.

[File No. 32-192]

IN THE MATTER OF NORTHERN INDIANA POWER COMPANY, CENTRAL INDIANA POWER COMPANY, HUGH M. MORRIS, SOLE SURVIVING TRUSTEE OF THE ESTATE OF MIDLAND UNITED COMPANY

NOTICE OF AND ORDER FOR HEARING (SUPPLEMENTAL)

Applications and declaration pursuant to the Public Utility Holding Company Act of 1935, having heretofore been duly filed with this Commission by Northern Indiana Power Company and Central Indiana Power Company, and a notice of and order for hearing thereon on February 6, 1940, having been issued by this Commission, dated January 17, 1940, and entitled "In the Matter of Northern Indiana Power Company and Central Indiana Power Company," which order was published in the FEDERAL REGISTER on January 19, 1940, Volume 5, No. 13, page 237; and further applications, pursuant to said Act, relating to the same subject matters as the applications and declaration above mentioned, having been subsequently filed with this Commission by Hugh M. Morris, sole surviving trustee of the Estate of Midland United Company;

It is ordered, That the proceedings under the several applications and declaration be joined for hearing of all of the matters in issue in such proceedings, said hearing to be held on February 6, 1940, at 10:00 o'clock in the forenoon of that day, at the Securities and Exchange Building, 1778 Pennsylvania Avenue NW., Washington, D. C., and that such proceedings be consolidated. On such day the hearing-room clerk in room 1102 will advise as to the room where such hearing will be held. At such hearing, if in respect of any declaration, cause shall be shown why such declaration shall become effective.

Further notice of such hearing is hereby given to such declarant or applicants and to any other person whose participation in such proceeding may be in the public interest or for the protection of investors or consumers. It is requested that any person desiring to be heard or to be admitted as a party to such proceeding file a notice to that effect with the Commission on or before February 5, 1940.

The said further applications filed by Hugh M. Morris, Sole Surviving Trustee of the Estate of Midland United Company, relate to (1) the sale of $939,100 principal amount of the bonds of Central Indiana Power Company to Central Indiana Power Company; (2) the sale of $200,000 principal amount of bonds of Attica Electric Company to Northern Indiana Power Company; and (3) the acquisition of the $100,000 Serial Note from Northern Indiana Power Company; as described in the said order for and notice of hearing dated January 17, 1940.

Applicant, Hugh M. Morris, Trustee of the Estate of Midland United Company, has designated Section 10 (a) (1) of the Public Utility Holding Company Act of 1935 and Rules U-12F-1 or U-12D-1 promulgated under the Act, as applicable to the above transactions.

By the Commission.

[SEAL] FRANCIS P. BRASSOR,
Secretary.

[F. R. Doc. 40-503; Filed, February 2, 1940; 12:25 p. m.]

United States of America—Before the Securities and Exchange Commission

At a regular session of the Securities and Exchange Commission, held at its office in the City of Washington, D. C., on the 2nd day of February, A. D. 1940.

[File No. 43-229]

IN THE MATTER OF NORTHERN NATURAL GAS COMPANY, DILLON, READ & CO.

ORDER TO SHOW CAUSE

Northern Natural Gas Company, a registered holding company and a subsidiary of Lone Star Gas Corporation, The United Light and Railways Company and The United Light and Power Company, and of North American Light & Power Company and The North American Company, registered holding companies, having filed a declaration, and amendments thereto, pursuant to Section 7 of the Public Utility Holding Company Act of 1935, with respect to the issue and sale of $16,000,000 aggregate principal amount of First Mortgage and First Lien Bonds, Series A, 3¼%, due July 1, 1954, and $6,000,000 aggregate principal amount of Unsecured Promissory Notes, 2⅛%, each of said notes being in the principal amount of $500,000; it being stated in the declaration that said bonds are to be sold privately and not to be resold, and that Dillon, Read & Co., a joint stock association engaged in the investment banking and securities underwriting business, is to receive from the declarant a fee in connection with the negotiation or consummation of the sale of said bonds, or for services in securing purchasers, amounting to ½ of 1% of the face amount sold, that is $80,000; a hearing pursuant to such declaration having been held by the Commission on July 25, 1939, and continued subject to the call of the Trial Examiner, and the declaration having been permitted to become effective as of August 1, 1939, subject to a reservation of jurisdiction by the Commission to determine at a later date, whether the fee to be paid to Dillon, Read & Co. in connection with the issue and sale of said bonds is or is not reasonable, and whether such fee should or should not be paid; and

It appearing to the Commission that Dillon, Read & Co., may stand in such

relation to Northern Natural Gas Company that there is liable to be or to have been an absence of arm's-length bargaining with respect to the transaction whereby Dillon, Read & Co. negotiated or consummated the sale of said bonds, or rendered services in securing purchasers.

It is ordered, Pursuant to Rule U–12F–2 of the General Rules and Regulations promulgated under the Public Utility Holding Company Act of 1935 that Northern Natural Gas Company and Dillon, Reed & Co., and each of them show cause on the 4th day of March, 1940, at ten o'clock in the forenoon of that day in Room 1103 of the Securities and Exchange Building, 1778 Pennsylvania Avenue, NW., Washington, D. C., why the Commission should not find that Dillon, Reed & Co. stands or stood in such relation to Northern Natural Gas Company that there is liable to be or to have been an absence of arm's-length bargaining with respect to the transaction whereby Dillon, Reed & Co. negotiated or consummated the sale of said bonds, or rendered services in securing purchasers; and

It is ordered, That Willis E. Monty be and he hereby is designated to preside at the hearing ordered herein. The officer so designated to preside at such hearing is hereby authorized to exercise all powers granted to the Commission under Section 18 (c) of said Act and to a trial examiner under the Commission's Rules of Practice; and

It is further ordered, That the procedings of the Order to Show Cause provided for herein be consolidated with the hearings on the declaration of Northern Natural Gas Company filed with this Commission pursuant to Section 7 of said Act.

By the Commission.

[SEAL] FRANCIS P. BRASSOR,
Secretary.

[F. R. Doc. 40–504; Filed, February 2, 1940; 12:25 p. m.]